LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

HEARINGS

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

MARCH 12 AND 13, 1987

Serial 100-15

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE
77-223 WASHINGTON : 1987

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, DC 20402

H781-7

COMMITTEE ON WAYS AND MEANS

DAN ROSTENKOWSKI, Illinois, *Chairman*

SAM M. GIBBONS, Florida
J.J. PICKLE, Texas
CHARLES B. RANGEL, New York
FORTNEY H. (PETE) STARK, California
ANDY JACOBS, Jr., Indiana
HAROLD FORD, Tennessee
ED JENKINS, Georgia
RICHARD A. GEPHARDT, Missouri
THOMAS J. DOWNEY, New York
FRANK J. GUARINI, New Jersey
MARTY RUSSO, Illinois
DON J. PEASE, Ohio
ROBERT T. MATSUI, California
BERYL ANTHONY, Jr., Arkansas
RONNIE G. FLIPPO, Alabama
BYRON L. DORGAN, North Dakota
BARBARA B. KENNELLY, Connecticut
BRIAN J. DONNELLY, Massachusetts
WILLIAM J. COYNE, Pennsylvania
MICHAEL A. ANDREWS, Texas
SANDER M. LEVIN, Michigan
JIM MOODY, Wisconsin

JOHN J. DUNCAN, Tennessee
BILL ARCHER, Texas
GUY VANDER JAGT, Michigan
PHILIP M. CRANE, Illinois
BILL FRENZEL, Minnesota
DICK SCHULZE, Pennsylvania
BILL GRADISON, Jr., Ohio
WILLIAM M. THOMAS, California
RAYMOND J. McGRATH, New York
HAL DAUB, Nebraska
JUDD GREGG, New Hampshire
HANK BROWN, Colorado
ROD CHANDLER, Washington

Joseph K. Dowley, *Chief Counsel*
M. Kenneth Bowler, *Deputy Chief of Staff*
Robert J. Leonard, *Chief Tax Counsel*
A.L. Singleton, *Minority Chief of Staff*

Subcommittee on Oversight

J.J. PICKLE, Texas, *Chairman*

BERYL ANTHONY, Jr., Arkansas
RONNIE G. FLIPPO, Alabama
BYRON L. DORGAN, North Dakota
HAROLD FORD, Tennessee
CHARLES B. RANGEL, New York
ANDY JACOBS, Jr. Indiana

DICK SCHULZE, Pennsylvania
BILL FRENZEL, Minnesota
WILLIAM M. THOMAS, California
RAYMOND J. McGRATH, New York

CONTENTS

Page
Press releases announcing the hearings 2

WITNESSES

U.S. General Accounting Office, Jennie S. Stathis, Associate Director, General Government Division, Helen Fauntleroy, Evaluator, and Andrea Kole, Counsel, Office of General Counsel 46
U.S. Department of the Treasury, Hon. J. Roger Mentz, Assistant Secretary for Tax Policy 71
Internal Revenue Service, Hon. Lawrence B. Gibbs, Jr., Commissioner of Internal Revenue 93
Federal Election Commission, Hon. Scott E. Thomas, Chairman, Hon. Thomas J. Josefiak, and Charles N. Steele, General Counsel 116

American Bar Association, Section of Taxation, John B. Jones, Jr., and Steven Simpson 129
American Cancer Society, National Advisory Commission on Cancer in Socio-Economically Disadvantaged, Harold P. Freeman, M.D 171
American Collectors Association, John W. Johnson 205
American Legion, Paul S. Egan 301
American Society of Association Executives, John W. Johnson 205
Argoff, Jeanne, the Dole Foundation for the Employment of Persons With Disabilities 256
Blackburn, Joseph W., Coalition of Health Services Organizations, Birmingham, AL 322
Bothwell, Robert O., National Committee for Responsive Philanthropy 317
Buchanan, John, People for the American Way 236
Center for a New Democracy, Hon. Martha E. Keys (former Member of Congress) 261
Coalition of Health Services Organizations, Birmingham, AL, Joseph W. Blackburn 322
Cohen, Sheldon S., Morgan, Lewis & Brockius, Washington, DC (former Commissioner of Internal Revenue) 222
Council on Non-Profit Organizations, Inc., Alan P. Dye 200
Disabled American Veterans, John F. Heilman 306
Dole Foundation for the Employment of Persons With Disabilities, Jackie A. Strange and Jeanne Argoff 256
Dye, Alan P., Council on Non-Profit Organizations, Inc 200
Egan, Paul S., the American Legion 301
Freeman, Harold P., M.D., Harlem Hospital Center, and American Cancer Society, National Advisory Commission on Cancer in the Socio-Economically Disadvantaged 171
Feulner, Edwin J., Jr., the Heritage Foundation 243
Harlem Hospital Center, Harold P. Freeman, M.D 171
Heilman, John F., Disabled American Veterans 306
Heritage Foundation, Edwin J. Feulner, Jr 243
Hopkins, Bruce R., Baker & Hostetler, Washington, DC 10
Hudson, Michael, Austin, TX 178
Hudson, Michael, People for the American Way 236
Independent Sector:
  Brian O'Connell 160
  Thomas A. Troyer 164
Indiana Coalition for Human Services, Betty Williams 196

Page
Indiana Planned Parenthood Association, Betty Williams 196
Johnson, John W., American Collectors Association, and American Society of Association Executives 205
Jones, John B., Jr., American Bar Association, Section of Taxation 129
Keys, Hon. Martha E., Center for a New Democracy (former Member of Congress) 261
Lehrfeld, William J., Lehrfeld & Henzke, Washington, DC 139
Lescault, James, Urban Educational Systems, Inc 329
Magill, James N., Veterans of Foreign Wars of the United States 311
Moskowitz, Jack, United Way of America 184
Mothers Against Drunk Driving, Norma Phillips 193
National Committee for Responsive Philanthropy, Robert O. Bothwell 317
North Carolina Democratic Party, John R. Wallace 286
O'Connell, Brian, Independent Sector 160
People for the American Way, John Buchanan and Michael Hudson 236
Phillips, Norma, Mothers Against Drunk Driving 193
Silverstein, Leonard L., Silverstein & Mullens, Washington, DC 146
Simpson, Steven, Section of Taxation, American Bar Association 129
Strange, Jackie A., Dole Foundation for the Employment of Persons With Disabilities 256
Troyer, Thomas A., Independent Sector 164
United Way of America, Jack Moskowitz 184
Urban Educational Systems, Inc., James Lescault 329
Veterans of Foreign Wars of the United States, James N. Magill 311
Wallace, John R., North Carolina Democratic Party 286
Williams, Betty, Indiana Planned Parenthood Association, and Indiana Coalition for Human Services 196

APPENDIXES

A. Congressional Research Service Report "Tax-Exempt Organizations: Lobbying and Political Activity" 341
B. Submissions for the record:
  American Heart Association, statement 390
  Council for Inter-American Security, statement 397
  Employee Benefit Research Institute, Education and Research Fund, Dallas Salisbury, statement 407
  Police Executive Research Forum, statement 409
  Schroeder, Hon. Patricia, a Representative in Congress from the State of Colorado, statement 414
  Swift, Hon. Al, a Representative in Congress from the State of Washington, and chairman, Subcommittee on Elections, Committee on House Administration, statement 416
  United States Catholic Conference, Mark E. Chopko and Deirdre Halloran, joint statement and attachments 418

LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

THURSDAY, MARCH 12, 1987

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, DC.

The subcommittee met, pursuant to notice, at 9 a.m., in room 1100, Longworth House Office Building, Hon. J.J. Pickle (chairman of the subcommittee) presiding.

[The press releases announcing the hearings follow:]

FOR IMMEDIATE RELEASE
THURSDAY, FEBRUARY 19, 1987

PRESS RELEASE #3
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
TELEPHONE: (202) 225-3627

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A HEARING TO REVIEW THE LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a hearing to review the Federal tax rules applicable to the lobbying and political activities of organizations that have tax-exempt status under section 501 of the Internal Revenue Code. These organizations include, among others: charitable, educational, etc., organizations; social welfare organizations; labor organizations; business leagues; and war veteran organizations. The hearing has been scheduled for Thursday, March 12, 1987, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 9:30 a.m.

The Subcommittee will investigate current law applicable to lobbying and political activities of tax-exempt organizations, and will determine the extent to which tax-exempt organizations undertake lobbying and engage in political activities. The Subcommittee also will investigate whether there has been any recent growth of activity in this area, consider the appropriateness of current law and policy in this regard, and review the adequacy of Internal Revenue Service (IRS) enforcement activities. It is emphasized that the scope of these hearings will include a review of the overall, basic definitions of lobbying and political activities, and will not include the recently proposed regulations by the Department of the Treasury regarding lobbying by organizations electing under section 501(h). Resolution of any specific controversy regarding these proposed regulations should be addressed through the normal administrative and regulatory process.

In general, current law provides various rules and limitations on lobbying and/or political activities by organizations exempt under the various paragraphs of section 501(c) of the Internal Revenue Code. For example, to be exempt under section 501(c)(3) of the Code, an organization cannot participate in, or intervene in (including the publishing or distribution of statements), any political campaign on behalf of any candidate for public office. In addition, no substantial part of the activities of a section 501(c)(3) organization may consist of carrying on propaganda or otherwise attempting to influence legislation. Under section 501(h), certain section 501(c)(3) organizations may elect to spend a limited amount of their expenditures in attempting to influence legislation without violating the "substantial part" test of section 501(c)(3). Rules that govern the lobbying and political activities of other exempt organizations are generally less restrictive than those applicable to organizations exempt under section 501(c)(3). Most recently, since 1975 certain political organizations have been eligible for limited tax exemption under section 527.

In announcing these hearings, Chairman Pickle stated: "The Committee on Ways and Means has not conducted a full and comprehensive review of the tax rules applicable to the lobbying and political activities of tax-exempt organizations, even though some of these rules date back to 1934. Recent events have raised questions about the extent to which tax-exempt organizations are engaged in lobbying and political activities. In light of these developments and the concerns

(more)

they raise, it is time for the Subcommittee to take a hard look at exactly what tax-exempt organizations are doing, and to determine what current law allows. We will also be reviewing the extent to which IRS is enforcing these laws. Taxpayers have a right to be assured that organizations enjoying favorable tax treatment are operating for the public benefit."

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD:

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone to Harriett Lawler [(202) 225-3627] no later than Friday, February 27, 1987, to be followed by a formal written request to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D. C. 20515. Requests should indicate the specific issues and points the witness wishes to address, in order to facilitate scheduling. It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. The Subcommittee staff will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee [(202) 225-5522)].

In order to assure the most productive use of the limited amount of time available, witnesses scheduled to present oral testimony are requested to briefly summarize their written statement in no more than five minutes. The full statement will be included in the printed record. Further, witnesses scheduled to appear before the Subcommittee are required to submit 150 copies of their prepared statement to the Subcommittee on Oversight office, room 1105 Longworth House Office Building, by close of business March 6, 1987. Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENT IN LIEU OF PERSONAL APPEARANCE:

Persons submitting a written statement in lieu of a personal appearance should submit six (6) copies of their statement by the close of business Friday, March 27, 1987, to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, room 1105 Longworth House Office Building, Washington, D. C. 20515. If those filing a written statement for the record of printed hearings wish to have their statement distributed to the press and the interested public at the hearing, they may provide 75 additional copies for this purpose to the Subcommittee office, room 1105 Longworth House Office Building, in advance of the public hearing.

SEE ENCLOSED FORMATTING REQUIREMENTS.

*****
****

**** NOTICE -- CHANGE IN LOCATION *****

FOR IMMEDIATE RELEASE
MONDAY, MARCH 9, 1987

PRESS RELEASE #3-REVISED
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1105 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
TELEPHONE: (202) 225-5522

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A CHANGE IN LOCATION FOR THE HEARING TO REVIEW THE LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, today announced a change in the location for the hearing on March 13, 1987 on the Federal tax rules applicable to the lobbying and political activites of organizations that have tax-exempt status under section 501 of the Internal Revenue Code. The hearing will be held in room 2322 Rayburn House Office Building rather than room 2247 Rayburn House Office Building as originally announced. As previously announced, the hearing will begin at 9:00 a.m.

All other details for the hearings on March 12 and 13, 1987 remain the same. (See Subcommittee press release #3, dated February 19, 1987 and press release #3-Revised, dated March 2, 1987.)

****

*** NOTICE--ADDITIONAL HEARING DAY AND CHANGE IN TIME ***

FOR IMMEDIATE RELEASE
MONDAY, MARCH 2, 1987

PRESS RELEASE #3-REVISED
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH HOUSE OFFICE BLDG.
WASHINGTON, D. C. 20515
TELEPHONE: (202) 225-3627

THE HONORABLE J. J. PICKLE (D., TEXAS), CHAIRMAN, SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS, U.S. HOUSE OF REPRESENTATIVES, ANNOUNCES A CHANGE IN SCHEDULE FOR HEARINGS TO REVIEW THE LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

The Honorable J. J. Pickle (D., Texas), Chairman of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a second day of hearings to review the Federal tax rules applicable to the lobbying and political activities of organizations that have tax-exempt status under section 501 of the Internal Revenue Code. The first day of hearings remains scheduled for March 12, 1987, and will begin at 9:00 a.m. in the main Committee hearing room, 1100 Longworth House Office Building. An additional hearing day has been scheduled for Friday, March 13, 1987, in room 2247 Rayburn House Office Building, beginning at 9:00 a.m.

All other details for the hearings remain the same (see press release #3, dated February 19, 1987).

Chairman **Pickle**. The Chair will ask the subcommittee to come to order.

The Chair has a preliminary statement to make. I should correct that by saying it is both a preliminary and an extensive statement. We're going to start on time so that we can proceed as rapidly as possible, but because of the subject matter involved and the complication of the subject matter, I am going into a more lengthy opening statement than we would normally have.

Mr. Schulze may have a statement in addition. So in the interest of time, we'll proceed, and I will move along as quickly as I can.

The Oversight Subcommittee has schedule 2 days of hearings to examine the lobbying and political activities of tax-exempt organizations. During the next 2 days, I plan to put on the public record information about development of the law, information about the current law rules, enforcement efforts by the Internal Revenue Service and the Federal Election Commission, and examples of what tax-exempt organizations are actually doing.

The subcommittee's preliminary investigation resulted in the following findings:

No. 1, although the issues and the concerns about lobbying and political activities of tax-exempt organizations are much the same today as in the 1930's and the 1940's and the 1950's and even the 1970's, they seem to be intensifying and growing.

No. 2, clear-cut definitional rules relating to lobbying and political activities are lacking in the law, and they are difficult to develop. There seems to be more gray than clear areas in the law.

No. 3, current law sanctions and penalties for noncompliance with present law rules lack teeth.

No. 4, the IRS isn't set up to identify lobbying or political activities violations very systematically, nor to act on allegations of misconduct in a timely manner.

No. 5, while the annual tax-exempt organization return, the Form 990, is quite lengthy, it is not very helpful to the IRS as an audit tool, nor very helpful to the public as a document disclosing actual tax-exempt organization lobbying or political activities.

Because of these general, broad outlines, I think the members of the committee and, I hope, the organizations involved will find that this hearing will be helpful in amplifying or clarifying some of these findings.

The hearings being held today and tomorrow are being conducted at the specific request of Chairman Dan Rostenkowski. The Oversight Subcommittee has been asked to consider the extent to which tax-exempt organizations undertake lobbying and engage in political activities, whether there has been any recent growth of activity in this area, the appropriateness of current law and policy in this regard, and the adequacy of IRS enforcement activities.

The scope of these hearings will include a review of the overall basic definitions of lobbying and political activity, but will not include the recently proposed 501(h) Treasury regulations.

I should note at the outset that this subcommittee is not, I want to emphasize this subcommittee is not, targeting any specific area or not conducting any investigative review toward any specific group. In the case of recent events involving Iran arm sales and the diversion of funds to the Contras, specific investigations are being undertaken by the appointed Independent Counsel, both the House and Senate committees, and appropriate Federal agencies such as the FBI.

In light of this activity, this committee, this subcommittee, is not the proper forum for the thorough investigation of activities of the involved tax-exempt organizations.

Should we find in the future, however, that a void exists because of Federal or congressional inaction, you can be sure that this subcommittee will move forward immediately and call its own investigative hearings on the subject. We are coordinating with these lead groups and governmental agencies, but not conducting an independent investigation of our own.

Now with regard to the Channell—the Carl Channell group or organization, I did call Commissioner Gibbs to my office and received a report on what the IRS knew, what was going on with Channell's organization, and how IRS handled such allegations of abuse. This information was given to me under my statutory authority to receive tax return information, which cannot subsequently be released to the public. Nonetheless, I can say that I am far from pleased by what I learned. I plan to discuss at length today how the IRS handles abusive situations and violations of the law.

I am concerned that the public sees and hears a steady stream of media reports about abuses in this area, and the IRS seems to be taking little or no action. The public gets the impression that the Internal Revenue Service is just looking the other way.

I want to add that I do not make that as a charge, but I want to say that's the general feeling by the public in many respects.

Further, findings in the Tower Commission report about involvement of tax-exempt groups in the funding of Contra activities, as well as numerous reports in the press, raise more questions than they give answers.

Clearly, most tax-exempt organizations are operating within the law and serving the public in a much needed educational and charitable manner. Many of these organizations have agreed to come forward and appear before this subcommittee. I appreciate the fact that they have volunteered, and, in advance, I wish to thank each of the ones who will testify for taking time to educate this subcommittee and the Congress about how your individual group involves itself in lobbying or political activity. Your views on the effect and appropriateness of current law restrictions are critical to the evaluation of the subject.

Today, I am going to ask each of you to give us the facts and data that this committee and the Congress need.

I want to note for the record, in contrast, that the Oversight Subcommittee staff, at my request, personally requested that a large number of additional tax-exempt organizations appear as witnesses at these hearings to discuss the groups' lobbying and political activities. The excuses they gave for refusing to testify were nonexcuses. Like the many groups testifying before this subcommittee over the next few days, these tax-exempt organizations were asked to come forward and provide information on: one, whether tax-exempt groups would be able to use deductible contributions to fund lobbying activities; two, to describe their political and lobbying efforts; and three, to discuss their views on the appropriateness and effectiveness of the present law.

Well, the Sierra Club refuses to appear. Carl Channell and his representatives refuse to appear. Pat Robertson refused to appear. Public Citizen and the American Medical Association refused to appear. The American Association of Retired Persons refused to appear, as did the group which has been studying the issue all year, the Center for Responsive Politics.

Not one church group agreed to my request to appear. This includes the United States Catholic Conference and the National Council of Churches.

Finally, not one union is finding its way to the subcommittee's hearings, and this includes refusal to appear by the AFL–CIO and the United Auto Workers.

Now, I acknowledge, and I want to make clear, that some groups had legitimate problems with appearing, and I am confident that we can work out testimony at a later date. However, there has been too much reservation about testifying before the Oversight Subcommittee. This prevents us, as Members of the Congress, from doing our jobs.

I make the names of these groups public to make two points. First, the reason we continue to wonder what tax-exempt organizations are doing is that, in part, because no one knows what tax-exempt organizations are doing. This includes the Congress, the IRS, and the public. Second, we are going to figure out what tax-exempt organizations are doing and report to the full Committee on Ways and Means. If necessary, we may recommend to change the law to make more tax-exempt organizations subject to public information. We intend to talk to the chairman about this problem.

Now let me now provide as an introduction examples of true cases where tax-exempt organizations have violated the law. A classic example of abuse was discovered at the committee's Subcommittee on Social Security hearing this week. One of the largest organizations dealing with issues affecting the elderly, the Roosevelt group, was found to be using the name of its 501(c)(3) organization to raise over $30 million. These moneys were deposited in and spent by its 501(c)(4) organization and almost entirely used to promote its legislative and grassroots lobbying activities. To the extent that taxpayers took deductions for contributions to the 501(c)(3), this cost the Federal Government millions of dollars. And I plan to ask IRS about that today, if they know whether they did or didn't make these claims.

It has also been found that 501(c)(3) tax-exempt organizations have given tax-deductible moneys to PAC's for use in funding campaigns for political office. In addition to this being a possible Federal election law violation, it has resulted in a tax-exempt organization merely being reclassified by the IRS as a 501(c)(4).

This raises questions. How much of this is going on, and are the sanctions in the present law enough?

Also it has been found that 501(c)(3) organizations have used tax-deductible dollars to pay for research time and employee salaries for publications used by 501(c)(4) organizations or by PAC's, often to promote an individual political candidate. While there is no law against this sharing staff, computers, or office space, proper allocation between the tax-exempt organization must be made. This raises a question: Does anyone know how tax-exempt organizations are allocating expenses between affiliated or commonly controlled groups? I doubt it.

Since this practice is so common, should we assume that the IRS has a grasp of how allocations are being made in the real world? Are tax-exempt organizations extensively using tax-deductible dollars to subsidize the lobbying or political activities on non-501(c)(3) tax-exempt groups?

Again, it has been found that after a tax-exempt organization has had its exempt status revoked by the IRS, the group merely reestablishes itself with the same board of directors, name, and daily activities.

Does anyone really care that this is going on? Does it make a mockery of our laws and our enforcement system?

Finally, it has been found that groups not eligible to receive tax-deductible contributions can mislead the average fellow with statements on literature such as: "Contributions are deductible to the fullest extent of the law." What does that mean?

Or "This organization is a nonprofit, tax-exempt organization which provides charitable work in the community."

Does the public realize that this does not necessarily mean that payments to such groups are tax deductible? Aren't such statements made to imply that contributions are deductible? I wonder, is anyone checking this?

Now some organizations are running fast and loose out there without regulations or controls. Some of them are skating on thin ice. This not only taints the activities of the responsible, straight-shooting organizations, but inhibits legitimate charitable and educational activities.

I think all of us today have a goal of identifying the problem areas that exist and getting them fixed, if we can find a way to do it.

Some will advocate expanding the law, and there may be good reasons for this. On the other hand, some will argue for more restrictions, and this also clearly deserves our attention.

So I look forward today to hearing the witnesses, learning more about our problems, so that the whole committee can consider it to see if we can find a better answer.

Now I say again, that concludes my statement. I recognize it was a rather lengthy one by comparison, but the subject is involved, and it is extensive, and it is complex, and I wanted to give you some of our preliminary findings or feelings on the subject without making any particular accusations.

Now the Chair would like to yield to Mr. Schulze, the ranking member of our committee, for any statements that he would like to make before we begin.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Chairman, I am pleased to join you in today's hearing on lobbying and political activities of tax-exempt organizations.

Most persons think of tax-exempt organizations as a single category, but there really are 25 different categories of tax-exempt organizations under the Internal Revenue Code.

It is the organizations described in section 501(c)(3) which most people think of as charities. The distinguishing feature of 501(c)(3) organizations is that they are devoted to promoting the general public good through some charitable, educational, or scientific or religious activity. These organizations include churches, universities, and humanitarian groups. It includes such familiar names as the Red Cross, the American Cancer Society, and the Salvation Army.

Section 501(c)(3) organizations are noble institutions which have enriched American society. They have strengthened us by fostering a healthy diversity of ideas and voluntary service.

The other tax-exempt organizations described in the remaining subsection of 501(c) also play an important role. However, these organizations generally are aimed at promoting the well-being of their particular membership, rather than promoting the general public welfare. Organizations in these categories include fraternal societies, labor unions, and business leagues.

All tax-exempt organizations share a similar benefit of not being taxable on donations. In addition, contributors to section 501(c)(3) organizations may deduct their donations as charitable contributions on their income tax.

Beginning with the Revenue Act of 1934, section 501(c)(3) organizations have been prohibited from engaging in substantial lobbying activities. The Internal Revenue Code of 1954 expanded the provisions to prohibit all political activities. The purpose behind these restrictions was to ensure that section 501(c)(3) concentrate their activities on the charitable purpose for which they were created. Those who wish to lobby more may form a tax-exempt organization under other categories, which permit substantial lobbying and political activity, such as a section 501(c)(4) organization.

Mr. Chairman, from the factsheet which the General Accounting Office prepared at your request, it appears that most charities have been very diligent in obeying the restrictions on lobbying and political activity. For example, in 1986, the IRS did examine 20,000 returns of tax-exempt organizations, and that resulted in only 25 organizations losing their tax-exempt status because of lobbying or political activity. This is about one-tenth of 1 percent of the total number.

While the number of charities which violate the restrictions is small, they cannot be ignored. A few bad apples can tarnish the image of the whole group. Furthermore, if the IRS were not vigilant in enforcing the restrictions, then more tax-exempt organizations might be encouraged to pursue extensive lobbying and political activity.

Mr. Chairman, I am looking forward to learning more about the operation of the lobbying and political rules from today's witnesses. In particular, I am anxious to hear about two things. First, are there any changes desirable to improve compliance, and second, are there changes desirable to enable charities to express themselves better on legislative issues?

Mr. Chairman, I would also like to know whether we should restrict section 501(c)(3) directors and personnel from affiliating with other tax-exempt groups or applying for another status. It may be that there is a better way to fence off these organizations, so that there is no commingling with so-called dummy foundations.

I might also add, from a cursory examination, it seems that there may be abuses both on the right and the left in this instance. I believe that our investigations should try to steer a course down the middle, so that we don't end up pointing the finger in one direction or the other. I am looking forward to receiving today's testimony, Mr. Chairman.

Chairman PICKLE. Thank you, Mr. Schulze. Now the Chair will recognize as our first panel Bruce Hopkins and Jennie Stathis. Mr. Hopkins is the author of the Law of Tax Exempt Organizations and is certainly recognized as one of the Nation's authorities in the field on this subject. Ms. Stathis is the Associate Director of the General Government Division of the GAO, the General Accounting Office.

We had asked the GAO to look into this question this last fall and we had talked with Mr. Hopkins to get a historical background of this subject legally and analytically which is why we have asked you to appear first.

Normally, we would recognize the Treasury and the IRS. They were cooperative this morning to step aside until you made this review and we appreciate their cooperation. Now we would like to hear from you, Mr. Hopkins, and then we will recognize you, Ms. Stathis, and we will proceed as rapidly as we can.

I am going to ask you and other witnesses, because we have a long list today, to follow your script or to summarize. If you summarize, try to tell us where you are in your presentation so we can follow you with your prepared testimony.

So we will first recognize Bruce Hopkins.

STATEMENT OF BRUCE R. HOPKINS, BAKER & HOSTETLER, WASHINGTON, DC

Mr. HOPKINS. Thank you, Mr. Chairman. Good morning to you and good morning to the other members of the subcommittee. I do have a formal statement. I will not read it. I will try to follow along, however, in its sequence as best I can.

As you said, Mr. Chairman, my responsibility this morning is to provide the subcommittee with a brief summary of the existing law pertaining to legislative activities and political campaign activities by tax exempt organizations and at the same time try to put all of this in some sort of a legal and historical perspective.

The place to begin in providing this perspective is to point out that, unlike State law, there is no Federal codified law of tax exempt organizations. That basically is left to the States so, by default, the Internal Revenue Code has become, in effect, the Federal codified law for tax-exempt organizations. Of course, this derives largely from the fact of the tax exempt status that is given to most forms of nonprofit organizations.

The concept of a nonprofit organization under U.S. law essentially is a product of the English common law. If you trace back over the centuries and look at the laws of property, estates, and trusts, you will find that there is the genesis of the law of nonprofit organizations.

Our law today, both State law and Federal law, largely through the tax law, mirrors the law that has been developed over the years through the common law system.

Another fundamental point that is important to focus on is the fundamental distinction between a nonprofit organization and a for-profit organization. Very simply put, a for-profit organization has owners in the nature of those who hold its equity and is operated for their benefit so that the net earnings that that entity generates flows back to them in their personal capacity.

By contrast, a nonprofit organization, although its net earnings may inure, they are supposed to inure to the organization's programs and not flow to individuals in their private capacity.

This distinction as to where the net earnings flow is the fundamental distinction between nonprofit organizations and for-profit organizations. That is directly reflected in today's Federal law dealing with tax exempt organizations.

As has been pointed out in the opening statements, most nonprofit organizations that are tax exempt under Federal law are those that are described in the Internal Revenue Code in section 501(c).

It has been said this morning that there are 25 different types of tax exempt organizations and that is because there are 25 subsections of the Internal Revenue Code section 501(c) but, in point of fact, there really are probably 50 or 60 or 70 different types of tax exempt organizations given the different types of entities that are described within the same provision.

Probably the most commonly known of the forms of exempt organizations are those that we recognize today in section 501(c)(3), the charitable, religious, educational and like organizations. Basically, contributions to these entities are tax deductible.

The Internal Revenue Code tells us specifically that no part of a 501(c)(3) organization's net earnings may inure to the benefit of persons in their private capacity. The statute and the regulations and the Internal Revenue Service rulings and the cases from the courts tell us that the other basic requirement of 501(c)(3) is that the organization must be organized and operated principally for public tax exempt purposes.

The entity that we know today as the 501(c)(3) organization has been in the statutory law since the inception of the income tax in 1913. Then, as has also been pointed out, we basically have the social welfare organization under 501(c)(4), the business league under 501(c)(6), the veterans organization under 501(c)(19), and the political organization under section 527.

There are, of course, many other types of exempt organizations but these are the principal ones that are a concern to the subcommittee this morning.

By in large, contributions to those organizations are not deductible as charitable gifts.

So from a historical perspective, what I have tried to summarize points out to fundamental points. Today's Federal tax law definition of tax exempt organizations, and particularly those that are charitable, generally directly mirrors the requirements that developed out of the common law.

The common law definition of "charity" essentially consists of the private inurement doctrine and the requirements that the organization be organized and operated for a public purpose. So 501(c)(3) is a direct reflection of the common law of charity.

I have dwelled on that because I wanted to make this fundamental point. There is nothing in the common law dealing with legislative activities by charitable organizations or political activities by charitable organizations.

As best as it can be traced in the cases, you go back to 1930 where Learned Hand told us that it is not appropriate for a charity to engage in what he termed "political agitation." There is no authority cited in that opinion for that proposition. So it seems that as far as the case law is concerned, that is where it started.

The prohibitions as to these activities have been added by Congress to the statutory law. They largely are the only provisions of section 501(c)(3) that one cannot see as having naturally flowed out of the common law. They have been added specifically by Congress.

These two proscriptions, both the one on political campaign activities and the one on legislative activities, have three remarkably similar characteristics.

No. 1, they were adopted by Congress without any hearings and thus there is no legislative history of any consequence as to their meaning.

No. 2, they were sponsored by Members of Congress who authored these amendments which were largely adopted on the floor with little debate due to their unhappiness with a particular nonprofit organization.

No. 3, they were adopted by the Senate.

At the time Congress was considering the legislation that became the Revenue Act of 1934 and while that legislation was on the floor of the Senate, Senator David Reed of Pennsylvania introduced an amendment that was drafted in the Finance Committee to prohibit so-called partisan politics and substantial lobbying by charitable organizations.

In my formal statement, I have provided the quotes that he made, the statements that he made on the floor, and I won't read all of them but it is crystal clear that his intent was not to address the tax-exempt status of organizations but that he was concerned about individuals making large gifts to charity that were earmarked for legislative purposes.

So the attempt was, the thought was as best as it can be discerned, to get at the problem from the charitable giving side rather than the tax exempt organization side.

At the same time, as his statement readily reflects, he was very unhappy with the language. He pointed out that the amendment "goes much further than the committee intended to go."

He said that he "did not reproach the draftsmen because we gave them an impossible task" and I think most noteworthy he pointed out that his amendment was "not designed to affect any of the worthy institutions."

The Senators abandoned their debate on this because they couldn't reach agreement on the amendment for 2 days. It was taken up again in the debate and they passed it largely with the intent of getting the amendment to conference and getting it corrected there. That is precisely what happened, again with Senator Reed pointing out that the legislative drafting counsel and the Finance Committee who drew the amendment expressed "no pride whatsoever in the product."

In conference, the reference to "partisan political" politics was dropped and we so have today, and this language was also engrafted onto the charitable giving sections, the language dealing with substantial lobbying by charities.

A decade later at the time Congress was considering the legislation that became the Internal Revenue Code of 1954 and again while that legislation was before the Senate, Senator Lyndon Johnson offered an amendment to prohibit political campaign activity by charities.

The Congressional Record does not reflect his motive but it is my understanding that he was concerned that a particular charitable foundation in Texas was in one manner or another causing some funds to flow into the campaign of an opponent.

Again, this amendment survived and its language is in the Internal Revenue Code today.

The rules in section 501(c)(3) and the charitable deductibility provisions specifically tell us that no substantial part of the activities of the charitable organization may consist of the carrying on of propaganda or otherwise attempting to influence legislation.

The regulations and to some extent the case law differentiates between direct lobbying which, of course, is lobbying by coming to the Hill and the State legislatures and testifying, speaking to Members and their staffs, and grassroots lobbying which is the effort made to have an impact on the opinion of the general public so that the members of the public will in turn contact their Members of Congress.

The principal controversy in this area has been the definition as to substantiality and, until Congress acted 10 years ago in enacting the elective rules, there really wasn't any guide at all as to what the term "substantial" meant.

There is some case law that tells us some of the guidelines and there is case law that tells us we can define it as a percentage of expenditures. There is case law that tells us that it can be done as a function of time expended and there is case law that tells us that it can be measured in terms of the organization's impact that it may have had on the legislative process.

Certainly one approach for attempting to measure substantiality is to determine what percentage of an organization's expenditures are devoted to efforts to influence legislation and that, of course, was what was done in 1976 with the elective rules.

As a summary as to the legislative activities rules, I would like to make five points. No. 1, despite many challenges in the courts, this proscription on legislative activities has repeatedly been found constitutional. The provision has been challenged on first amendment grounds and it has been challenged on equal protection grounds.

No. 2, there is a view at the Supreme Court that this proscription in 501(c)(3) is constitutional only because of the ease of utilization by a charitable organization of a related 501(c)(4) group.

No. 3, there is a distinction to be made between legislative or advocacy activities and educational or objective activities.

No. 4, Congress has acted in this area most recently in 1969 when it basically prohibited legislative activities by private foundations.

No. 5, in recognition of the confusion generated by the substantiality test, Congress in 1976 enacted the so-called safe haven rules which are in 501(h), 4911, and other sections.

As far as the political campaign activities rules are concerned, for 501(c)(3)'s, the statute tells us that they may not participate in or intervene in—including the publishing or distributing of statements—any political campaign on behalf of any candidate for public office.

Under the regulations of the Treasury Department, an organization that engages in substantial lobbying activity or that engages in political campaign activities is denominated an "action" organization and it is denied or revoked exemption.

I will not describe all of the revenue rulings that I have indicated in my formal statement. I put those in simply to indicate that the definition of this proscription by the Internal Revenue Service is extremely broad and encompassing.

Again, as a summary on the political campaign activities side, I wish to make the following points.

No. 1, in the view of the Internal Revenue Service, the prohibition on political campaign activities by 501(c)(3) organizations is absolute. In other words, we do not have the substantiality threshold that we have for legislative activities.

No. 2, a 501(c)(3) organization may not maintain a related political action committee.

No. 3, in 1969, Congress basically prohibited political campaign activities by private foundations.

No. 4, there is a distinction to be made between political campaign activities and educational activities, the best example of the latter being the so-called voter education activities.

No. 5, there are forms of activities that can be generally called political that are not necessarily political campaign activities.

That review essentially focused on the 501(c)(3) organizations.

As to the other types of entities, let me quickly run through the rules.

On 501(c)(4)—excuse me, sir.

Chairman Pickle. In the interest of time, I wonder if you could summarize some of your observations.

Mr. Hopkins. I'd be happy to do that.

Chairman Pickle. I find this very interesting. We have a copy of your entire document, and I'm glad that the people who are here this morning could hear this review. But we need to move along as quickly as possible.

I would like to ask all witnesses, if they could, to try to summarize their testimony in approximately 5 to 7 minutes. I don't want to stop you, if you need more time, because we're not trying to cut you off, but we have a long list and we need to move as quickly as we can.

So if you will try to summarize.

Mr. Hopkins. I will do that, Mr. Chairman. Thank you.

The observations I would conclude with appear on the last page of my formal statement, and I put these in as just questions and thoughts to open the discussion. The first one is this:

Is there anything necessarily inappropriate about lobbying and/or political campaign activities by 501(c)(3) or other tax-exempt organizations? By that I mean, should the law tolerate certain forms of lobbying, or certain forms of campaign activities, by charitable organizations that are in direct furtherance of their tax-exempt purposes?

If it were to be determined that the answer to the foregoing is that these activities are not appropriate for charitable organizations, then of course the question must be, is the present language in section 501(c)(3) suitable?

Another question is, should the rule for 501(c)(3) organizations, with respect to lobbying, be more akin to the business expense rules that appear in 162(e), which allow direct lobbying activities by business organizations, where those activities are in furtherance of their tax-exempt purposes?

Another observation would be this: Should any tax-exempt organization have lobbying as its principal function?

And finally, and this aspect of it was already touched upon, Mr. Chairman, in your opening statement, should Congress address in this context the matter of tax-exempt organizations operating what I call "in tandem"? For example, should lobbying by 501(c)(3) organizations be prohibited, yet allow (c)(3) organizations to have controlled lobbying organizations?

This is a relatively common practice today, to have lobbying activity housed in a 501(c)(4) entity where the other activities are housed in a 501(c)(3) entity.

And finally, should Congress address in this context the matter of founding, funding, governance and operation of related tax-exempt organizations by other tax-exempt organizations?

As I said in my statement, Mr. Chairman, I appreciate the opportunity to be here this morning, and would be pleased to answer any questions you or the other members of the subcommittee may have.

[The prepared statement and attachments follow:]

Statement of
Bruce R. Hopkins
Baker & Hostetler
Washington, D.C.

Mr. Chairman and the other members of the Subcommittee on Oversight --

Thank you for the opportunity to appear before you this morning.

At the request of the staff of the Subcommittee, I am submitting as background material copies of the chapters of my book, The Law of Tax-Exempt Organizations (5th ed. 1987), concerning the federal tax law rules for charitable organizations that summarize the law restricting legislative activities (Chapter 13) and political campaign activities (Chapter 14) by these organizations. Also, at the request of the staff, I am submitting a copy of an article I wrote that appears in the March 1987 issue of the Journal of Taxation (Vol. 66, No. 3, page 152) which summarizes the proposed tax regulations for public charities that elect the "safe haven" lobbying rules.

In addition to being in private practice, I am a member of the adjunct faculty of the George Washington University, where I teach the course in the law of tax-exempt organizations at the University's National Law Center.

My purpose this morning is to provide the Subcommittee with a brief summary of the existing law pertaining to legislative and political campaign activities by tax-exempt organizations. As part of this process, I have been asked to provide a brief description of the evolution of the federal tax law in these areas.

Introduction

There is no federal codified law of nonprofit organizations as legal entities. This body of law is essentially left to the states (such as the state corporation acts).

Consequently, by default, the Internal Revenue Code has become the federal codified law for nonprofit organizations. This, of course, has evolved because of the feature of tax exemption.

Federal (and state) law concerning nonprofit organizations is a product of the English common law. Indeed, United States law today for nonprofit organizations essentially is a continuation of the basic principles developed in the common law over the centuries. The origins of today's concept of the nonprofit organization are directly traceable to the traditional laws of property, estates, and trusts.

Fundamentally, the law -- then and now -- makes a fundamental distinction between a for-profit organization and a nonprofit organization. A for-profit organization has "owners" -- those persons who hold its equity (such as shareholders in a business corporation) and for whom the organization is operated, in that its net earnings (such as dividends) are paid (inure) to them as a return on their investment. A nonprofit organization does not have owners and its net earnings are to be devoted to its program functions.

This fact -- the distinction in the manner in which net earnings inure -- is the heart of the difference between for-profit and nonprofit organizations. Thus, the distinction is not whether "profits" (excess of revenue over expenses) are earned but the recipient(s) of the profits.

The concept of the nonprofit organization and the tax-exempt organization are not necessarily the same. An organization can be nonprofit without being tax-exempt.

Under today's law, most nonprofit organizations that are tax-exempt are those that are described in Internal Revenue Code of 1986 section ("IRC §") 501(c).

The Charitable Organization

The organizations that are the subject of this hearing include those that are charitable, educational, religious, and the like. (For this purpose, these organizations will be generically referenced as "charitable."[1]) These organizations are referenced in today's federal tax law in IRC § 501(c)(3). Contributions to IRC § 501(c)(3) organizations generally are deductible for federal income tax purposes under IRC § 170(c)(2).

Thus, an organization described in IRC § 501(c)(3) is a non-profit, tax-exempt entity. Therefore, by reason of the common law, no part of an IRC § 501(c)(3) organization's net earnings may inure to the benefit of persons in their private capacity. This requirement is specifically stated in IRC § 501(c)(3),[2] along with the requirement that the charitable organization be organized and operated principally[3] for tax-exempt purposes.[4]

The types of organization referenced in IRC § 501(c)(3) have been recognized as tax-exempt entities since the inception of the federal income tax in 1913.

Other Tax-Exempt Organizations

The other categories of tax-exempt organizations of relevance to this inquiry by the Subcommittee are several and nearly all are likewise referenced in IRC § 501(c).

Congress has created the tax-exempt social welfare organization, described in IRC § 501(c)(4). In general, contributions to social welfare organizations are not deductible.

The tax-exempt business league is described in IRC § 501(c)(6). Charitable contributions to business leagues are generally not deductible as gifts; the business expense deduction (IRC § 162) may be available.

---

[1] So held in Bob Jones University v. United States, 461 U.S. 574 (1983).

[2] Also Income Tax Regulations ("Reg.") § 1.501(c)(3)-1(c)(2).

[3] Better Business Bureau of Washington, D.C. v. United States, 326 U.S. 279 (1945).

[4] Reg. § 1.501(c)(3)-1(a).

The tax-exempt veterans' organization is described in IRC § 501(c)(19). Contributions to veterans' organizations are deductible for federal income tax purposes under IRC § 170(c)(3).

Congress has enacted a category of tax exemption for political organizations, described in IRC § 527. The political contributions tax credit was repealed by enactment of the Tax Reform Act of 1986.

Historical Perspective

The foregoing yields these pertinent points:

1. The federal tax law definition of tax-exempt organizations generally directly mirrors the requirements developed out of the common law.
2. The common law definition of "charity" essentially consists of the private inurement doctrine and the requirement that the organization be operated for a "public" (charitable) purpose.

Therefore, IRC § 501(c)(3) is a direct reflection of the common law of charity.[5]

However, the common law is silent on two aspects of today's federal codified law of charity. These aspects are legislative activities and political campaign activities.

Origins of the Lobbying and Political Campaign Activity Prohibitions as Applied to Charities

There is nothing in the English common law of charity that prohibits a charitable organization from engaging in legislative activities or political campaign activities. One federal appellate court decision, authored in 1930, holds that tax-exempt charitable organizations may not engage in "[p]olitical agitation."[6]

The prohibitions as to these activities were added by Congress as part of the statutory law. Therefore, the striking aspect of these prohibitions is that they are the only features of IRC § 501(c)(3) that have not evolved out of the common law of charity.

These two proscriptions have remarkably similar characteristics:

1. They were adopted by Congress without hearings and thus there is no legislative history of any consequence as to their meaning.
2. They were sponsored by Members of Congress who authored these amendments, which were adopted on the floor with little debate, due to their unhappiness with a particular nonprofit organization.
3. They were adopted by the other body.

---

[5] There is a striking similarity between IRC § 501(c)(3) and the Preamble to the Statute of Charitable Uses (1601).

At the time Congress was considering the legislation that became the Revenue Act of 1934, and while that legislation was before the United States Senate, Senator Reed of Pennsylvania spoke to an amendment to restrict "partisan politics" and lobbying by charities. On that occasion, he stated that the purpose of the amendment was to prohibit tax exemption for "any organization that is receiving contributions, the proceeds of which are to be used for propaganda purposes or to try to influence legislation."[7] He said that the intent of the Committee on Finance, where the amendment originated, was to deny deductibility of a contribution as a charitable gift "if it is a selfish one made to advance the personal interests of the giver of the money."[8] Observing that he did "not reproach the draftsmen" as "I think we gave them an impossible task," Senator Reed said that "this amendment goes much further than the committee intended to go."[9] He noted: "Mr. President, as that amendment is worded, it would apply to the Society for the Prevention of Cruelty to Children, to the Society for the Prevention of Cruelty to Animals, or any of the worthy institutions that we do not in the slightest mean to affect."[10]

Indeed, the Senators abandoned their consideration of the amendment (on April 2, 1934) and deferred it to later in the debate, when (on April 4, 1934) it was again taken up. There, Senator Harrison observed that the intent of the Finance Committee was to stop deductible contributions for legislative ends.[11] Senator Reed stated that he did "not think that the committee is proud of the language in which this amendment is couched" and that the "legislative drafting counsel who drew it expressed no pride whatsoever in their product."[12]

Senator Reed said that, following adoption of the amendment, "we will have from now until the conference to study the project and prepare better phraseology."[13]

The language was indeed changed in conference, with deletion of the reference to "partisan politics," and the language enacted in this regard has survived and remains embodied in IRC § 501(c)(3) today with this language.

At the time Congress was considering the legislation that became the Internal Revenue Code of 1954, and while that legislation was before the United States Senate, Senator Lyndon B. Johnson offered an amendment to prohibit political campaign activity by charities. Although the record[14] does not reflect his motive, he was unhappy because a charitable foundation in Texas

---

[6] Slee v. Commissioner, 42 F. 2d 184, 185 (2d Cir. 1930).

[7] 78 Cong. Rec. 5861 (1934).

[8] Ibid.

[9] Id.

[10] Id.

[11] 78 Cong. Rec. 5959 (1934).

[12] Ibid.

[13] Id.

[14] 88 Cong. Rec. 9128 (1954).

was (ostensibly) channeling some funds into the campaign of an opponent and he wished to end that practice. This amendment also survived and remains embodied in IRC § 501(c)(3) today with the original language.

The Lobbying Rules for Charities

The rules in IRC § 501(c)(3) that restrict lobbying by charitable organizations state that "no substantial part of the activities ... [of the organization may consist of the] carrying on [of] propaganda, or otherwise attempting to influence legislation."

A charitable organization is regarded as attempting to influence legislation, according to the tax regulations, if it (1) contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation, or (2) advocates the adoption or rejection of legislation.[15] Under these general rules, if a substantial part of an organization's activities is attempting to influence legislation, the organization is denominated an "action" organization and thus cannot qualify as a charitable entity.

Where a charitable organization receives a contribution that is earmarked for use in influencing specific legislation, the contribution is not deductible as a charitable gift.[16]

The term "legislation" has several manifestations, principally action by Congress, a state legislative body, a local council, or similar governing body, and the general public in a referendum, initiative, constitutional amendment, or similar procedure.[17]

A determination as to whether a specific activity or category of activities of an exempt organization is "substantial" must basically be a factual one and, until enactment of the elective rules in 1976, the law offered no formula for computing "substantial" or "insubstantial" legislative undertakings. Thus, the Senate Finance Committee, in its report accompanying the Tax Reform Act of 1969, said that "the standards as to the permissible level of [legislative] activities under the present law are so vague as to encourage subjective application of the sanction."[18] In its report accompanying the Tax Reform Act of 1976, the Senate Finance Committee portrayed the dilemma this way: "Many believe that the standards as to the permissible level of [legislative] activities under present law are too vague and thereby tend to encourage subjective and selective enforcement."[19]

One approach for attempting to measure substantiality in this context is to determine what percentage of an organization's spending is devoted on an annual basis to efforts to "influence legislation." Yet the prohibition against legislative influencing may have been intended to involve more than simply an expenditure or diversion of funds and to include restrictions on certain levels of activity. A portion of an organization's efforts and activities devoted to legislative activities may well be regarded as more important than the organization's expenditures for the purpose.[20] It was once suggested that five percent of an organization's time and effort which involves legislative activities is not "substantial."[21]

---

[15] Reg. § 1.501(c)(3)-1(c)(3)(ii)

[16] E.g., Revenue Ruling ("Rev. Rul.") 80-275, 1980-2 C.B. 69.

[17] Reg § 1.501(c)(3)-1(c)(3)(ii).

[18] S. Rep. No. 91-552, 91st Cong., 1st Sess. (1969), at 47.

[19] S. Rep. No. 94-938 (Part 2), 94th Cong., 2d Sess. (1976), at 80.

However, in the context of activities, a percentage standard may be of less utility. An exempt organization enjoying considerable prestige and influence might be considered as having a "substantial" impact on the legislative process solely on the basis of a single official position statement, an activity considered negligible when measured according to a percentage standard of time expended.[22] A standard such as this, however, would tend to place undue emphasis on whether or not a particular legislative effort was successful.[23]

In 1972, the U.S. Court of Appeals for the Tenth Circuit gave a new dimension to the concept of "attempting to influence legislation," when it upheld the revocation of tax exemption of the Christian Echoes National Ministry.[24] The court, after holding that the pertinent income tax regulations properly interpret the intent of Congress (before enactment of the elective rules), found the following "substantial" legislative activities: articles constituting appeals to the public to react to certain issues, support or opposition to specific terms of legislation and enactments, and efforts to cause members of the public to contact Members of Congress on various matters. Of particular consequence was the court's explicit rejection of a percentage test in determining "substantiality," which was dismissed as obscuring the "complexity of balancing the organization's activities in relation to its objectives and circumstances."[25] Said the court: "The political [i.e., legislative] activities of an organization must be balanced in the context of the objectives and circumstances of the organization to determine whether a substantial part of its activities was to influence or attempt to influence legislation."[26]

---

[20] League of Women Voters v. United States, 180 F.Supp. 379 (Ct. Cl. 1960), cert. den., 364 U.S. 822 (1960).

[21] Seasongood v. Commissioner, 227 F.2d 907, 912 (6th Cir. 1955).

[22] Kuper v. Commissioner, 332 F.2d 562 (3d Cir. 1964), cert. den., 379 U.S. 920 (1964).

[23] Haswell v. United States, 500 F.2d 1133, 1142 (Ct. Cl. 1974), cert. den., 419 U.S. 1107 (1974); Dulles v. Johnson, 273 F.2d 362, 367 (2d Cir. 1959), cert. den., 364 U.S. 834 (1960).

[24] Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849 (10th Cir. 1972), cert. den., 414 U.S. 864 (1973).

[25] Ibid. at 855

[26] Id.

As a summary, I wish to make these points:

1. Despite many challenges, this proscription has repeatedly been found constitutional.[27]

2. There is a view at the Supreme Court that this proscription is constitutional only because of the ease of utilization by an IRC § 501(c)(3) organization of an IRC § 501(c)(4) lobbying arm.[28]

3. There is a distinction to be made between legislative (advocacy) activities and educational (objective) activities.

4. In 1969, Congress basically prohibited legislative activities by private foundations,[29] which are a subset of the IRC § 501(c)(3) community.

5. In recognition of the confusion generated by the substantiality test, Congress in 1976 enacted the "safe-haven" rules of IRC §§ 501(h), 4911, and related provisions, which indirectly define, as a function of expenditures, the concept of "substantiality."

The Political Campaign Activity Rules For Charities

The rules in IRC § 501(c)(3) that essentially prohibit campaign activities by charitable organizations state that this type of organization may "not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

A charitable organization is denominated an "action" organization when it engages in political campaign activities.[30]

The scope of this proscription may be seen in some representative Internal Revenue Service revenue rulings. The IRS has ruled that a charitable organization may not evaluate the qualifications of potential candidates in a school board election and then support particular slates in the campaign.[31] On the other hand, the IRS has ruled that a university is not participating in a political campaign by providing a political science course that required the students' participation in political campaigns of their choice[32] nor by provision of faculty advisors and facilities for a campus newspaper that publishes the students' editorial opinions on political matters.[33] Also, an exempt broadcasting station that provides equal air time to all electoral candidates in compliance with the Federal Communications Act does not violate the proscription against partisan political activities.[34]

---

[27] E.g., Regan v. Taxation With Representation of Washington, 461 U.S. 540 (1983).

[28] Ibid. at 553.

[29] IRC § 4945(d)(1).

[30] Reg. § 1.501(c)(3)-1(c)(3)(iii).

[31] Rev. Rul. 67-71, 1967-1 C.B. 125.

[32] Rev. Rul. 72-512, 1972-2 C.B. 246.

Despite the requirement of a "political campaign" and a "candidate for public office," the IRS has denominated as an action organization (and thus denied exemption to) an organization formed for the purpose of implementing an orderly change of administration of the office of governor of a particular state in the most efficient and economical fashion possible by assisting the governor-elect during the period between his election and inauguration.[35] Without any statement of its reasoning, the IRS ruled that a presidential inaugural committee that sponsors inaugural activities, some of which are open to the public and some by invitation only, where donations to it were commingled with the proceeds from various fund-raising affairs and activities, is not an organization organized and operated exclusively for charitable purposes.[36]

As with the rules concerning legislative activities, there is a distinction between political campaign activities and educational activities. Thus, for example, voter education activities are generally permissible.[37] Also in private letter rulings, the Internal Revenue Service has generally permitted charitable organizations to rate candidates in connection with their positions on selected issues.

As a summary, I wish to make these points:

1. In the view of the IRS, this proscription is absolute -- as opposed to the "substantiality" threshold for legislative activities.
2. An IRC § 501(c)(3) organization may not maintain a related political action committee.
3. In 1969, Congress basically prohibited political campaign activities (electioneering) by private foundations.[38]
4. There is a distinction to be made between political campaign activities and educational (e.g., voter education) activities.
5. There are forms of "political" activities that are not political campaign activities.

---

[33] Rev. Rul. 72-513, 1972-2 C.B. 246.

[34] Rev. Rul. 74-574, 1974-2 C.B. 160

[35] Rev. Rul. 74-117, 1974-1 C.B. 128.

[36] Rev. Rul. 77-283, 1977-2 C.B. 72.

[37] E.g., Rev. Rul. 78-248, 1978-1 C.B. 154.

[38] IRC § 4945(d)(2).

The Lobbying and Political Campaign Activities Rules as Applied to Other Tax-exempt Organizations

There are no restrictions as to lobbying by social welfare (IRC § 501(c)(4)) organizations. Generally, a social welfare organization cannot engage in political campaign activities,[39] although it is permitted to engage in these activities to an insubstantial extent.[40] Therefore, within these limitations, an IRC § 501(c)(4) organization may establish and utilize a political action committee.

There are no restrictions as to lobbying by business leagues (IRC § 501(c)(6)) organizations. A business league may maintain a political action committee. Grassroots lobbying and political campaign activity by business leagues is indirectly constrained by special rules eliminating the business expense deduction for outlays for such activity.[41]

There are no restrictions as to lobbying by veterans' organizations (IRC § 501(c)(19) entities).

A Summary

As the foregoing reflects, there are three fundamental points to be made:

1. The federal tax law rules for the categories of tax-exempt organizations that are the subject of this hearing generally are reflected in the multi-century development of the English common law.

2 The principal exceptions to the foregoing statement are the rules pertaining to legislative activities and political campaign activities by tax-exempt organizations.

3. The rules concerning legislative and political activities by IRC § 501(c)(3) organizations were not developed as the result of broad policy formulation but rather because of the personal predilections of specific Members of Congress.

Some Concluding Observations

Although my mission this morning is to generally explain the existing law of lobbying and political campaign activities by tax-exempt organizations, and how it came into being, I cannot resist concluding with some observations in the nature of posing some policy questions for this Subcommittee's consideration.

---

[39] Reg. § 1.501(c)(4)-1(a)(2)(ii).

[40] Rev. Rul. 81-95, 1981-1 C.B. 332.

[41] IRC § 162(e).

These observations are:

1. Is there anything inappropriate about lobbying and/or political campaign activities by IRC § 501(c)(3) and/or other tax-exempt organizations?

2. If the answer to the foregoing is yes, is the present language in IRC § 501(c)(3) suitable?

3. Any answer to question number 1 deserves a written rationale from Congress and a communication of that rationale to the nonprofit community.

4. Should the rule for IRC § 501(c)(3) organizations with respect to lobbying be akin to IRC § 162(e) rather than existing law?

5. Are the rules for private foundations in these areas appropriate?

6. To return to the original point, is it appropriate for an IRC § 501(c)(3) organization to advance its charitable purposes by means of legislative activities and/or political campaign activities?

7. Should any tax-exempt organization have lobbying as its principal function?

8. Should Congress address, in this context, the matter of tax-exempt organizations operating in-tandem? For example:

   a. Should lobbying by IRC § 501(c)(3) organizations be prohibited, yet allow IRC § 501(c)(3) organizations to have and control related lobbying organizations?

   b. The same may be said with respect to political campaign activities.

   c. Should Congress address in this context the matter of founding, funding, governance, and operation of related tax-exempt organizations by other tax-exempt organizations?

I appreciate the opportunity to appear before the Subcommittee on these important matters.

I would be pleased to answer any questions the Subcommittee may have.

PROPOSED REGULATIONS ADDRESS LOBBYING EXPENDITURES OF PUBLIC CHARITIES

Charities that lobby on legislative issues now have safe-harbor guidelines to test their expenditures against and so avoid excise tax.

BY BRUCE R. HOPKINS

The Treasury and the IRS issued Proposed Regulations on 10/5/86 concerning the permissible lobbying expenditures of eligible public charities. The proposals are rather extensive and will require substantial analysis for affected organizations.

The Regulations are a considerable amplification of Sections 501(h), 504 and 4911 enacted a decade ago, as part of the Tax Reform Act of 1976. The rules provide guidance, at least some of which is in the form of mechanical tests, as to allowable lobbying by eligible public charities. This is opposed to the vagaries of the general rule for charitable organizations, which is that no "substantial part" of the activities of a charitable organization shall be the conduct of legislative activities. The rules afford safe-harbor guidelines, that can be used only by election on Form 5768.

In most respects, the Proposed Regulations are a fair reflection of the statute. However, the definition of "influencing legislation" and some of the provisions in the area of cost allocation are somewhat unfair, as is the concept of "fund-raising."

The comment period for these Proposed Regulations closes on 4/3/87.

Current Law

The current statutory rules define the term "legislation" in Section 4911(e)(2), differentiate between direct and grass roots lobbying,[1] set percentage limitations on allowable lobbying of both types, apply an excise tax on excess lobbying expenditures, and determine when an organization can lose its tax exemption because of substantial lobbying. Exceptions to the rules are provided, as are rules mandating consolidation of lobbying expenditures by affiliated organizations.

Permissible lobbying expenditures are a function of outlays termed "exempt function expenditures" in Section 4911(e)(1). Certain otherwise legitimate expenditures of charitable organizations are called "excluded expenditures." Such expenditures, under Section 4911(e)(1)(C), include fund-raising expenses.

The safe-harbor guidelines of Section 501(h)(1) define the permissible and impermissible ranges of legislative activities by charitable organizations in terms of the expenditure of funds, *i.e.*, "lobbying expenditures." Entities that choose to not make the election with its "expenditure test," are governed by the "substantial part" test, with all of its uncertainties. Churches, conventions or associations of churches, integrated auxiliaries thereof, termed "disqualified organizations" in Section 501(h)(5), certain supporting entities of noncharitable organizations[2] and private foundations may not elect to come under these guidelines. Organizations that are permitted to elect the expenditure test are "eligible organizations."[3]

The safe-harbor standards are formulated in terms of declining percentages of total exempt function expenditures (which, as noted, cannot include fund-raising expenses). The basic permitted annual (albeit averaged over the most recent four-year period) level of expenditures for legislative activities (*i.e.*, "lobbying nontaxable amount") is 20% of the first $500,000 of an organization's exempt purpose expenditures, plus 15% of the next such $500,000, 10% of the next $500,000, and 5% of any remaining expenditures. However, the total spent for legislative activities in any one year by an organization may not exceed $1 million as provided by Section 4911(c)(2). A specific limitation—amounting to 25% of the foregoing amounts—is imposed on the expenses associated with attempts to influence the general public on legislative matters, termed the "grass roots nontaxable amount" in Section 4911(c)(4).

A charitable organization that has elected these limitations but exceeds either or both of them, becomes subject, under Prop. Reg. 1.501(h)-3, to an excise tax in the amount of 25% of the excess lobbying expenditures. As respects these two limitations, the tax falls on the greater of the two excesses. If an electing organization's lobbying expenditures normally (that is, on an average over a four-year period) exceed 150% of either the "lobbying ceiling amount" or the "grass roots ceiling amount," it will lose its tax-exempt status as a charitable entity under Section 501(h)(2)(B) or (D) respectively.[4]

Influencing Legislation. Section 4911(d)(1) defines the term "influencing legislation" as any attempt to influence any legislation through an attempt to affect the opinions of the

---

BRUCE R. HOPKINS, of the D.C. Bar, is a partner in the Washington, D.C. law firm of Baker & Hostetler. He has appeared previously in THE JOURNAL and is the author of *The Law of Tax-Exempt Organizations* (Wiley).

general public or any segment thereof ("grass roots lobbying") and through communication with any member or employee of a legislative body or any other governmental official or employee who participates in the formulation of the legislation ("direct lobbying"). Expenditures for lobbying are not only those paid or incurred for lobbying but those made "in connection with" lobbying—an expansive reading of the concept.

Five categories of activities are excluded from the term "influencing legislation."[5] These are:

1. Making available the results of nonpartisan analysis, study, or research.

2. The provision of technical advice or assistance to a governmental body or subdivision thereof in response to a written request by that entity.

3. Appearances before, or communications to, any legislative body with respect to a possible decision of that body which might affect the existence of the organization, its powers and duties, its tax-exempt status, or the deduction of contributions to it (the so-called "self-defense" exception).

4. Communications between the organization and its bona fide members with respect to legislation or proposed legislation of direct interest to them, unless the communications directly encourage the members to influence legislation or directly encourage the members to urge nonmembers to influence legislation.

5. Routine communications with governmental officials or employees.

Affiliated Groups. Expenditures are aggregated under Section 4911(f), to prevent the use of numerous organizations to avoid these tests. Thus, where two or more charitable organizations are members of an affiliated group and at least one of them has elected coverage under these guidelines, the calculations of lobbying and exempt purpose expenditures must be made by taking into account the expenditures of the group. If these expenditures exceed the permitted limits, each of the electing member organizations must pay a proportionate share of the penalty excise tax, with the nonelecting members treated under the general rules.

Generally, two organizations are deemed "affiliated" under Section 4911(f)(2), where one organization is able to control action on legislative issues by the other pursuant to its governing instrument or the governing board of one organization includes enough representatives of the other (*e.g.*, an "interlocking directorate") to cause or prevent action on legislative issues by the first organization. Where a number of organizations are affiliated, even in chain fashion, all of them are treated as one affiliated organization. However, if a group of autonomous organizations controls an organization but no one organization in the controlling group alone can control that organization, the organizations are not considered an affiliated group by reason of the interlocking directorates rule.

Control by one organization over another need not be exercised to cause affiliation; it is sufficient that the ability to control exists.

In order to make information about the legislative activities of electing charitable organizations obtainable by the public, Congress expanded the required contents for annual information returns filed on the Forms 990 series. Thus an electing organization must disclose the amount of its total and grass roots lobbying expenditures, together with the amount that it could have spent for legislative purposes without becoming subject to the 25% excise tax, pursuant to Section 6033(b)(8). An electing organization that is a member of an affiliated group must provide this information with respect to both itself and the entire group.

Overview of Proposed Regulations

The Proposed Regulations state the procedure for electing, revoking, and re-electing the expenditure test. They greatly amplify all aspects of the statutory rules, and include considerable detail in connection with affiliated groups of organizations. Examples of calculations involving exempt purpose expenditures and taxable and nontaxable amounts and lobbying expenditures are provided.

The Proposed Regulations also deal with the charitable contribution deduction rules,[6] the organizational and operational test rules,[7] the private foundation taxable expenditures rules (concerning grants to electing public charities), and the estate and gift tax regulations.[8]

Concept of "Lobbying." As noted, Section 4911(d)(1) differentiates between direct and grass roots lobbying. Expenditures for direct lobbying, discussed in Prop. Reg. 56.4911-2(b)(1), include amounts paid or incurred as current or deferred compensation for an employee's services in connection with direct lobbying, and the allocable portion of administrative, overhead, and other general expenditures attributable to direct lobbying. A similar rule in Prop. Reg. 56.4911-2(c)(1) applies to grass roots lobbying.

Prop. Reg. 56.4911-2(b)(2) discusses the concept of the "direct lobbying communication." This is a communication that attempts to influence legislation through direct lobbying and which pertains to legislation being considered by a legislative body, or which seeks or opposes legislation, and reflects a view with respect to the desirability of the legislation. This is a very expansive view of the concept of direct lobbying, particularly the "pertains to" phraseology and the reference to the seeking of legislation, and may be contrasted with the definition of lobbying employed in the private foundation context, which is narrower in scope.[9]

As to the "reflecting a view" requirement, set forth in Prop. Reg. 56.4911-2(b)(2)(ii), a communication pertaining to legislation but expressing no explicit view on the legislation would be deemed to reflect a view on legislation if the communication is selectively disseminated to persons reasonably expected to share a common view of the legislation. This rule may pose some difficulties for organizations that focus their program activities (such as position papers, seminars, and conferences) principally on their constituencies.

A direct lobbying communication also is one made to a member or employee of a legislative body or to a government official or employee who may participate in the formulation of legislation. In the case of a communication to an employee, Prop. Reg. 56.4911-2(b)(2)(iii) requires the principal purpose of the communication to be to influence legislation.

Similar rules apply with respect to grass roots lobbying. The principal distinction, as stated in Prop. Reg. 56.4911-2(c)(1)(iii), is that a grass roots lobbying communication is one that is communicated in a form and distributed in a manner so as to reach individuals as members of the general public: that is, as voters or constituents. Thus, it is not designed for academic, scientific, or similar purposes. A communication may meet this test even if it reaches the public only indirectly, as in a news release submitted to the media.

Electing the Expenditure Test

An eligible organization may elect the expenditure test, under Prop. Reg. 1.501(h)-2(a), for any taxable year beginning after 1976. The election is made by filing Form 5768 and is effective beginning with the taxable year in which the form is filed, according to Section 501(h)(6). Once made, the election is effective for each succeeding taxable year for which the organization is an eligible organization until a notice of revocation is filed.

A newly created organization may elect the expenditure test before the IRS determines it to be an eligible organization. The election may be made at the time of submission of a Form 1023 application for recognition of tax exemption. If the IRS determines that a newly created organization is a private foundation, the organization will be liable for the excise taxes on amounts expended in attempts to influence legislation. However, if a newly created organization is neither a private foundation nor a disqualified organization but is determined by the IRS not to be an eligible organization, its election will not be effective and the substantial part test will apply from the date the organization becomes recognized as a charitable organization.

In deciding whether an eligible organization should elect the expenditure test, the status of the organization under the substantial part test should be given consideration. If lobbying expenditures are "insubstantial," the substantial part test will preserve the organization's tax exemption and the election is not necessary. As noted, however, the substantial part test does not embody a precise determinant of allowable lobbying expenditures. Thus, an organization with lobbying expenditures close to but short of the expenditure test's permissible lobbying expenditures generally should elect the expenditure test. An organization that has lobbying expenditures in a year in excess of the expenditure test's permissible amounts should elect the expenditure test, on the general assumption that the expenditure test allowable amount of lobbying expenditures is greater than the maximum amount under the substantial part test. However, that assumption is not always correct, as illustrated by the fact that the substantial part test does not distinguish between direct lobbying expenditures and grass roots expenditures. As a result, an organization which only has grass roots expenditures may be able to make such expenditures under the substantial part test (and remain exempt) to a greater extent than would be permissible under the expenditure test.

An organization may voluntarily revoke an expenditure test election by filing a notice of voluntary revocation with the appropriate Internal Revenue Service Center. A voluntary revocation is effective, under Section 501(h)(6)(B), with the beginning of the first taxable year after the taxable year in which the notice is filed. Thereafter, the substantial part test would apply. If an organization's expenditure test election is voluntarily revoked, Prop. Reg. 1.501(h)-2(d)(1) provides that the organization may again make the election, effective no earlier than the taxable year following the first taxable year for which the revocation is effective.

If, while an expenditure test election is in effect, the organization ceases to be an eligible organization, its election is automatically revoked. The revocation is effective with the beginning of the first full taxable year for which it is determined that the organization is not an eligible organization. If an organization's expenditure test election is involuntarily revoked but the organization continues to be a charitable entity, the substantial part test will apply with respect to the organization's activities in attempting to influence legislation beginning with the first taxable year for which the involuntary revocation is effective, according to Prop. Reg. 1.501(h)-2(d)(2).

Affiliated Organizations

There are two ways by which one organization is deemed affiliated with another for purposes of the lobbying rules. Control by one organization over another need not be exercised to cause affiliation; it is sufficient that the ability to control exists. Two noncharitable organizations require a common affiliated charitable organization to be affiliated with one another, according to Prop. Regs. 56.4911-7(a)(1) and (2).

Affiliation by means of a governing instrument occurs where the instrument of the controlled organization expressly or by implication limits the independent action of it on a legislative issue by requiring it to take into account the position of the controlling organization on the issue. Any such limitation, under Prop. Reg. 56.4911-7(c), is adequate to establish affiliation and it is immaterial how or whether the limiting power is exercised.

Affiliation by reason of interlocking governing boards occurs where the controlling organization has a sufficient number of representatives on the governing board of the controlled organization so that, by aggregating their votes, the representatives of the controlling organization

---

[1] Sections 501(h)(2)(A), (C), 4911(c)(1), (3), and (d).

[2] Section 501(h)(4)(F).

[3] Section 501(h)(3) and (4); Prop. Reg. 1.501(h)-2(b).

[4] Such an organization cannot convert to a tax-exempt social welfare organization; Section 504, Prop. Reg. 1.504-1.

[5] Section 4911(d)(2); Prop. Reg. 56.4911-3 and 5.

[6] Prop. Regs. 1.170A-1(h)(5) and (h)(11).

[7] Prop. Regs. 1.501(c)(3)-1(b)(3) and 1(c)(3)(ii).

[8] Prop. Regs. 20.2055-1(a)(2) and 25.2522(a)-1(a)(2).

[9] See Reg. 53.4945-2(b)(1).

[10] Prop. Reg. 56.4911-8(c).

can cause or prevent action on legislative issues. Once there is the requisite interlocking of boards, how or whether the representatives of the controlling organization vote on any particular matter is immaterial under Prop. Reg. 56.4911-7(b).

Prop. Reg. 56.4911-7(b)(5) provides an elaborate definition of the term "representative" for these purposes. Generally, a board member of a controlled organization is a representative of a controlling organization if the controlling organization has specifically designated that person to be a member of its board. Such a representative can be designated by the governing instrument of the controlled organization by: (1) being specifically designated to sit on its governing board, or (2) being selected for a position that has a right to board membership.

There are four other special rules that pertain to the definition of a representative and thus the matter of affiliation:

1. A board member of one organization who is specifically designated by a second organization, a majority of the governing board of which is made up of representatives of a third organization is a representative of the second and third organizations.

2. A board member of one organization who is also a member of the governing board of a second organization is a representative of the second organization.

3. A board member of one organization who is an officer or paid executive staff member (or other employee possessing substantial executive authority) of a second organization is a representative of the second organization.

4. A person with no authority to vote on any issue being considered by the governing board is not a representative of any organization.

Generally, representatives of a controlling organization who are also members of the governing board of a controlled organization are presumed able to cause or prevent action on legislative issues if they constitute a majority of incumbents or a quorum (or are sufficient to prevent a quorum) for acting on legislative issues. However, if a lesser number of votes is sufficient to cause or prevent action on legislative issues, that number is considered adequate to establish the requisite control. Nonetheless, if the number of representatives is less than 15% of the incumbents on the governing board of the second organization, the two organizations are not affiliated by reason of the interlocking governing board rule.

If a controlling organization is affiliated with each of two or more controlled organizations, the controlled organizations are affiliated with each other, under Prop. Reg. 56.4911-7(d). Under the "chain rule," if one organization is a controlling organization with respect to a second organization and that second organization is a controlling organization with respect to a third organization, the first organization is considered affiliated with the third organization.

An electing organization can be liable for all or a portion of the tax on the excess lobbying expenditures of the affiliated group.

For these purposes, the phrase "action on legislative issues" includes taking a position in the organization's name on legislation, authorizing any person to take such a position in the organization's name, or authorizing any lobbying expenditures. However, the term does not include actions taken merely to correct unauthorized actions taken in the organization's name.

Following a determination that two or more organizations are affiliated, Prop. Reg. 56.4911-7(e) requires a further determination as to whether the organizations constitute an "affiliated group." An affiliated group is a group of organizations meeting the following criteria:

1. Each organization is affiliated with every other organization during at least 30 days of the taxable year of the affiliated group.

2. Each organization is eligible to elect the expenditure test.

3. At least one organization had an expenditure test election in effect on at least one day of the taxable year of the affiliated group.

An organization can be a member of two or more affiliated groups and, once a member of an affiliated group, is considered a member for the affiliated group's entire taxable year.

Where all members of an affiliated group have the same taxable year, that year is the taxable year of the affiliated group. Where the group members have different taxable years, the taxable year of the affiliated group is the calendar year, unless each of the members of the affiliated group elects to treat its own taxable year as the taxable year of the affiliated group. The Proposed Regulations state the process for making this election.

Because an affiliated group is treated as a single organization, its lobbying expenditures, grass roots expenditures, and exempt purpose expenditures for the taxable year are the sums of these expenditures paid or incurred by the members of the group, according to Prop. Regs. 56.4911-8 and 9. The group's lobbying nontaxable amounts, grass roots nontaxable amounts, lobbying ceiling amounts, and grass roots ceiling amounts are likewise ascertained.

Tax on Affiliated Groups

The tax on excess lobbying expenditures is imposed on an affiliated group if the group has excess lobbying expenditures during the taxable year.[10] An affiliated group's excess lobbying expenditures are the greater of the amount by which the group's lobbying expenditures exceed its lobbying nontaxable amount or the amount by which the group's grass roots expenditures exceed its grass roots nontaxable amount.

An electing member organization can be liable for all or a portion of the tax on the excess lobbying expenditures of the affiliated group. Such an organization is not also liable for tax on its own excess lobbying expenditures. A member of an affiliated group that has not elected the expenditure test is not liable for any portion of the tax imposed on the affiliated group, according to Prop. Reg. 56.4911-8(d).

If the tax imposed on the excess lobbying expenditures of an affiliated group is based upon excess lobbying expenditures and if at least one electing member has made lobbying expenditures, each electing member is liable for its allocable portion of the tax, on the basis of its lobbying expenditures in relation to the lobbying expenditures of all electing members during the year. The same rule is applicable with respect to the tax on excess grass roots expenditures. A tax allocation rule applies to electing member organizations where no electing member made lobbying or grass roots expenditures, with the allocation based on the exempt purpose expenditures of the organization and of all the electing member organizations in the affiliated group.

An electing member organization that is liable for a tax under these rules is treated as if the tax were imposed for its taxable year with which or within which ends the taxable year of the affiliated group. If an organization is liable for two or more taxes on the excess lobbying expenditures of two or more affiliated groups, the organization is liable only for the largest tax.

Loss of an Affiliate's Tax-Exempt Status

The rules concerning the loss of tax-exempt status for excessive lobbying apply to members of affiliated groups based upon the expenditures of the group. If for a taxable year of an affiliated group, the sum of the group's lobbying or grass roots expenditures for its "base years" (*i.e.*, the taxable year of the determination and the three preceding years) exceeds 150% of the sum of its corresponding nontaxable amounts for the base years, each member that is an electing member at any time in the taxable year of the group will be denied tax-exempt status, beginning with its first taxable year commencing after the end of such taxable year of the group. The exemption will continue to be denied unless the organization reapplies and is recognized as a charitable organization.

An organization that is a member of an affiliated group of organizations but is not an electing member organization remains subject to the substantial part test.

Filing Requirements. The Proposed Regulations impose certain filing requirements upon each member of an affiliated group of organizations for the taxable year of the member with which, or within which, ends the taxable year of the affiliated group. Under Prop. Reg. 1.6033-2(a)(2)(ii)(*k*), each member must provide to every other member, before the first day of the second month following the close of the group's taxable year, its name, identification number, and the information required for reporting purposes for its expenditures during the group's taxable and base years. For groups that elect to have each member file with respect to the group based on the member's own taxable year, each member must provide the information enumerated above by treating each taxable year of any member of the group as a taxable year for the group. Also, each member must provide on its annual return the group's taxable year and, if the election is made, the name, identification number, and taxable year identifying the return with which its consent to the election was filed. Further, each electing member must provide on its annual return the name and identification number of each member of the group and the appropriate calculation of the tax on excess lobbying expenditures of the group, if the organization is liable for the tax.

Limited Affiliated Group. Prop. Reg. 56.4911-10 introduces the concept of the "limited affiliated group of organizations." This phrase refers to two or more organizations where each organization is a member of an affiliated group of organizations, no two members of which are affiliated by reason of the interlocking governing boards rule, and no member, under its governing instruments, is bound by decisions of another member on legislative issues other than "national legislative issues." A national legislative issue is legislation limited to action by the Congress or by the public in any national procedure, although if an issue is both national and local, it will be characterized as a national legislative issue if the contemplated legislation is Congressional. The Proposed Regs. generally apply to electing members of a limited affiliated group individually. Generally, if such members are not electing organizations, they are subject to the substantial part test.

However, special rules apply to "controlling member organizations" of a limited affiliated group. A member of a limited affiliated group is a controlling member organization if it controls one or more of the other members of the limited affiliated group. A member of a limited affiliated group is a controlled member organization if it is controlled by one or more of the other members of the limited affiliated group. A controlling member organization for which the expenditure test election is in effect must include in its direct lobbying expenditures for its taxable year the direct lobbying expenditures paid or incurred with respect to national lobbying issues by each member of the limited affiliated group that it controls. A like rule applies with respect to grass roots expenditures. However, the exempt purpose expenditures of a controlling member organization do not include the exempt purpose expenditures (other than lobbying expenditures) of any organization that is a controlled member organization as to it.

The Proposed Regulations impose upon controlling member organizations and controlled member organizations of limited affiliated groups certain reporting requirements, similar to those applicable to affiliated groups of organizations.

Fund-Raising

As a result of the Proposed Regulations, the Federal Government is for the first time developing Regulations defining and applying the concept of "fund-raising." Thus, the Proposed Regulations are directly applicable and of concern to the professional fund-raising community, not only because of their specific intended application but because of the larger regulatory implications of the proposed definition of fund-raising. The regulatory focus on the term "fund-raising" results from Congress excluding amounts used for a "separate fund-raising unit" from "exempt purpose expenditures" in Section 4911(e)(1)(C) when such amounts are paid or incurred "primarily for fund-raising."

While Section 4911 does not define

the term "fund-raising," the term "exempt function expenditure" is defined to include program outlays and administration and lobbying expenses.

Prop. Reg. 56.4911-4(f)(1) defines the term "fund-raising" to include:

1. Soliciting dues or contributions from members of an organization, from persons whose dues are in arrears, or from the general public.

2. Soliciting grants from businesses or other (including charitable) organizations.

3. Soliciting grants from a governmental unit or any agency or instrumentality thereof.

Some in the professional fund-raising community may be surprised to see the term "fund-raising" so broadly defined, particularly when it comes to the solicitation of dues.

A "separate fund-raising unit" of an organization must, according to Prop. Reg. 56.4911-4(f)(2), consist of: (1) two or more individuals a substantial part of whose time is spent on fund-raising for the organization, or (2) any separate accounting unit of the organization that is devoted to fund-raising.

Although presently confined to use in the lobbying regulation context, it may be presumed that these definitions of "fund-raising" and "separate fund-raising unit" will find their way into more expansive use.

Cost Allocations

One of the principal issues facing nonprofit organizations on an ongoing basis is the matter of cost allocations. For example, the fund-raising community has long struggled with state regulators over the proper manner in which to allocate (if at all) a portion of single expenditure to fund-raising where the charity believes the expenditure was partially for fund-raising and partially for another other purpose (*e.g.*, program or administration purposes). The disputes have largely been over application of a "reasonableness" test, which permits allocation in a reasonable manner, or a "primary purpose" test, which likely causes the entire outlay to be allocated to fund-raising.

Prop. Reg. 56.4911-2(d)(1) generally adopts the reasonableness test for so-called "mixed purpose expenditures" with respect to allocating them among lobbying, program and fund-raising purposes. Thus, they approve of "a reasonable allocation, based on all the facts and circumstances."

Some in the fund-raising community may be surprised to see the term "fund-raising" so broadly defined, particularly when it comes to the solicitation of dues.

However, Prop. Reg. 56.4911-2(d)(2) also contains some vestiges of the primary purpose test. For example, if an expenditure is made for both grass roots lobbying and fund-raising purposes, the entire expenditure is treated as a grass roots lobbying expenditure, a result that will prove troublesome in the direct mail fund-raising context. However, an expenditure for fund-raising literature is not made for grass roots purposes if the literature merely mentions that the organization engages in attempts to influence legislation only to the extent consistent with its tax-exempt, charitable status.

Another example of the primary purpose test is that an expenditure made for both direct lobbying and grass roots lobbying purposes (so-called "mixed lobbying") is generally treated as a grass roots expenditure by Prop. Reg. 56.4911-2(d)(3). Also, if any part of an advertisement constitutes grass roots lobbying, the entire amount expended for or in connection with the advertisement constitutes a grass roots expenditure, under Prop. Reg. 56.4911-2(c)(1).

Membership Organizations

Other rules in the Proposed Regulations are of particular interest to membership organizations. These rules, in Prop. Reg. 56.4911-5, attempt to differentiate between expected communications with members and direct or grass roots lobbying.

A communication pertaining to legislation or proposed legislation is not lobbying where the communication is directed only to members of the organization, the legislation is of direct interest to the organization and its members, and the communication does not directly encourage the member to engage in direct or grass roots lobbying. Nonetheless, an expenditure for a member-only communication that reflects a view with respect to the desirability of legislation and which encourages direct or grass roots lobbying is treated as an expenditure for direct or grass roots lobbying, respectively.

Other rules classify communications as to legislation directed to members and nonmembers.

Private Foundations

The Proposed Regulations address the matter of private foundation grants to public charities that attempt to influence legislation. Generally, Section 4945(d)(1) provides that a private foundation cannot expend funds for legislative ends without making a "taxable expenditure." Prop. Reg. 53.4945-2(a)(5) further provides that a private foundation cannot make a grant to a public charity that is earmarked to influence legislation.

Under Prop. Reg. 53.4945-2(a)(6), a general support grant by a private foundation to a public charity is not a taxable expenditure to the extent that the grant is not earmarked for legislative ends and the amount of the grant does not exceed the greater of: (1) the amount expended by the grantee in the taxable year preceding the year of the grant, or (2) the amount budgeted for the year of the grant by the grantee for its exempt purpose expenditures (other than lobbying expenditures) and fund-raising expenditures.

A grant by a private foundation to fund a specific public charity project is not a taxable expenditure to the extent that the grant is not earmarked for legislative ends and the amount of the grant does not exceed the amount budgeted for the year of the grant by the grantee for specific project activities which are not attempts to influence legislation.

The "amount of the grant" is: (1) the sum of the grantor's general support grants and specific project grants made to the same grantee for the same taxable year of the grantee, or (2) the sum of the grantor's general support grants and the grant for the specific project made to the grantee for the same taxable year of the grantee, and (3) each grant attributed to the grantor even if by another private foundation.

Attribution of a grant occurs when there is an oral or written agreement between private foundations to give grants and they are made in the same taxable year of the grantee.

The Proposed Regulations also address the matter of a private foundation grant to a public charity that thereafter ceases to be a tax-exempt charitable organization because of lobbying activity. Such a grant is not a taxable expenditure under Proposed Reg. 53.4945-2(a)(7) if:

1. The grant meets the requirements for private foundation grants to public charities that lobby.

2. The grant is made before notice of loss of exempt status of the grantee is given by the IRS to the public.

3. At the time the grant is made, no foundation manager of the grantor private foundation knows (or, in some instances, has reason to know) that the grantee's ruling or determination letter has been or will be revoked, or is aware of the activities which would provide the basis for the revocation.

4. No disqualified person with respect to the foundation, during the grantee's taxable year in which the grant is made, or the preceding or succeeding taxable year, controls, in whole or in part, the grantee's attempts to influence legislation. ★

NEW DECISIONS

Education fund failed to show end of segregation support. (CA)

The Tax Court upheld IRS revocation of the exempt status of an education fund originally established to fund segregated private schools.

Held: Affirmed. The fund failed to show that it now supported a non-discriminatory admission policy, required of charitable organizations. *Virginia Education Fund*, CA-4, 8/20/86.

Advertising receipts from magazine were unrelated business taxable income. (TC)

Taxpayer, an exempt organization, published a magazine which contained articles relating to the duties of police officers. The magazine also contained two types of business listings, one of which was a business directory listing similar to those found in the Yellow Pages, and the other of which consisted of "large listings" that contained the usual elements of advertisements and were listed in an "Advertiser's Index" showing where they appeared. The Service determined that all receipts from both listings constituted unrelated business taxable income.

Held: For the Commissioner. Income from the business listings is taxable if the publication of the listings is a trade or business, is regularly carried on, and is not substantially related to the taxpayer's tax-exempt purposes. Both types of listings are advertisings since they contained slogans, logos, trademarks, and other information which is similar to listings found in newspapers and journals. The magazine used the word "advertising" with respect to both listings when dealing with the publishing company, and this is a further indication that they were considered advertising. Furthermore, the advertising was done with a profit motive since the taxpayer's share of the receipts from the magazine was based upon gross revenues. Since the activities constituted advertising and were not related to the taxpayer's exempt purposes and were regularly carried on the receipts are unrelated business taxable income taxable under Section 511. *Fraternal Order of Police, Illinois State Troopers Lodge No. 41*, 87 TC No. 45.

Religious organization exempt from taxation. (TC)

Taxpayer, an auxiliary of the United Methodist Church, was formed to contract for construction of housing at a conference and retreat center. It was created as a separate corporation to avoid state construction liability laws. Its principal purpose was to contract for housing construction on Church grounds. The housing was required for individuals involved in the planning, organization or operation of religious programs and activities. The taxpayer filed an application for exemption as an organization described in Section 501(c)(3) that is not a private foundation under Sections 509(a)(1) and 509(a)(3). The Service issued a proposed adverse ruling, and the taxpayer brought this action for a declaratory judgment.

Held: For taxpayer on Section 501(c)(3) and Section 509(a)(3) issues (but not on Section 509 (a)(1) issue). The Service conceded that the taxpayer meets the organizational test under Section 501(c)(3). The taxpayer also meets the operational test since the housing units were to be constructed, sold and used to further the exempt purposes of the Church The taxpayer did not compete with commercial contractors and sufficient controls were instituted to assure that no substantial nonexempt purpose would be accomplished. *Junaluska Assembly Housing, Inc.*, 86 TC No. 64.

Individual practice association denied both social welfare and business league exemptions. (Rev. Rul.)

An individual practice association, established to negotiate the delivery of health services with health maintenance organizations, was denied exemption from tax as a social welfare organization under Section 501(c)(4) or as a business league under Section 501(c)(6). To qualify for exemption under Section 501(c)(4), an organization must be operated primarily for the purpose of bringing about civic betterments and social improvements. Section 501(c)(6) provides for the exemption of business leagues which are not organized for profit and as long as no part of the net earnings inure to the benefit of any private shareholder or individual. Because the association functioned primarily as a billing and collective bargaining representative negotiating on behalf of its member physicians, it failed to qualify under either Section 501(c)(4) or Section 501 (c)(6). *Rev. Rul.* 86-98, IRB 1986-33.

Nonacquiescence

The Service does not acquiesce in *St. Joseph Farms of Indiana*, 85 TC 9 (1985) (IRB 1986-30).

14

Political Activities

Charitable organizations[1] are deemed to meet four basic criteria, one of which is that these organizations must "not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office."

This criterion has an origin remarkably similar to that of the proscription on substantial legislative activities by charitable groups.[2] This provision was added, during Senate debate, as a floor amendment offered by then-Senator Lyndon B. Johnson to the bill which subsequently became the Internal Revenue Code of 1954. The proposal was made in an attempt to curb the activities of a private foundation in Texas that Senator Johnson believed had provided indirect financial support to his opponent in an election.

§ 14.1 Scope of Proscription

The prohibition on involvement by an exempt charitable organization in a political campaign is generally supposed to be absolute, although neither the legislative history of the provision nor the regulations provide much clarification.[3] The IRS states that "this is an absolute prohibition," adding that "[t]here is no requirement that political campaigning be substantial."[4] However, analogy may be made to a comparable statute which is also absolute on its face: section 610 of the Federal Corrupt Practices Act. That Act makes "[i]t . . . unlawful for . . . any corporation whatever . . . to make a contribution or expenditure in connection with" various federal elections. Nonetheless, the courts have read a substantiality test into the absolute proscription of § 610.[5] Further, it has been stated that "a slight and comparatively unimportant deviation from the narrow furrow of tax approved activity is not fatal."[6]

---

[1] That is, organizations described in IRC §§ 170(c)(2)(B), 501(c)(3), 2055(a)(2), 2106(a)(2)(A)(ii) and (iii), and 2522(a)(2) and (b)(2).

[2] See Chapter 13.

[3] ~~See~~ Reg. §§ 1.501(c)(3)-1(b)(3)(ii), 1.501(c)(3)-1(c)(iii).

[4] IRS Exempt Organizations Handbook (IRM 7751) § 370(2).

[5] *United States* v. *Constructional Local 264*, 101 F.Supp. 873 (W.D. Mo. 1951); *United States* v. *Painters Local 481*, 172 F.2d 854 (2d Cir. 1949).

An exempt organization which is found to have engaged in political activities would be deemed an "action" organization, because "it participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office."[7]

§ 14.2 "Political Campaign" Activities

The requirement that a charitable organization not engage in political campaign activities is relatively clear as to meaning, particularly as compared to the questions raised by the limitation on legislative activities. Because of this relative clarity, the matter has infrequently been the subject of discussion in the cases or in IRS rulings. However, the IRS has ruled that a charitable organization may not evaluate the qualifications of potential candidates in a school board election and then support particular slates in the campaign.[8] Also, the Tax Court has held that an organization established with the dominant aim of bringing about world government as rapidly as possible does not qualify as a charitable organization.[9] On the other hand, the IRS has ruled that a university is not participating in a political campaign by providing a political science course that required the students' participation in political campaigns of their choice[10] nor by provision of faculty advisors and facilities for a campus newspaper that publishes the students' editorial opinions on political matters.[11] Also, an exempt broadcasting station that provides equal air time to all electoral candidates in compliance with the Federal Communications Act does not violate the proscription against partisan political activities.[12]

Despite the requirement of a "political campaign" and a "candidate for public office," the IRS has denominated as an action organization (and thus denied exemption to) an organization formed for the purpose of implementing an orderly change of administration of the office of governor of a particular state in the most efficient and economical fashion possible by assisting the governor-elect during the period between his election and inauguration.[13] The Service ruled that the organization's "predominant purpose is to effectuate changes in the government's policies and personnel which will make them correspond with the partisan political interests of both the Governor-elect and the political party he represents." Without any statement of its reasoning, the IRS ruled that a presidential inaugural committee that sponsors inaugural activities, some of which are open to the public and some by invitation only, where donations to it were commingled with the proceeds from various fund-raising affairs and activities, is not an organization organized and operated exclusively for charitable purposes.[14] It appears, however, that an inaugural committee would qualify as a social welfare organization[15] under the law governing tax exemption for such entities.[16]

---

[6] *St. Louis Union Trust Co.* v. *United States*, 374 F.2d 427, 431–432 (8th Cir. 1967).

[7] Reg. § 1.501(c)(3)-1(c)(3)(iii). See Chapter 5.

[8] Rev. Rul. 67-71, 1967-1 C.B. 125.

[9] *Estate of Blaine* v. *Commissioner*, 22 T.C. 1195 (1954).

[10] Rev. Rul. 72-512, 1972-2 C.B. 246.

[11] Rev. Rul. 72-513, 1972-2 C.B. 246.

[12] Rev. Rul. 74-574, 1974-2 C.B. 160.

[13] Rev. Rul. 74-117, 1974-1 C.B. 128.

Such an expansion of this prohibition on political activities was furthered even more by the U.S. Court of Appeals for the Tenth Circuit, in denying tax-exempt status to the Christian Echoes National Ministry for engaging in legislative activities and intervening in political campaigns.[17] Christian Echoes did not formally endorse specific candidates for office; rather, by means of publications and broadcasts, it attacked candidates and incumbents (presidents, congressmen) considered too liberal and endorsed conservative officeholders. The court summarized the offense: "These attempts to elect or defeat certain political leaders reflected Christian Echoes' objective to change the composition of the federal government."[18] However, it would appear that open criticism of an elected public official, even one who is eligible for reelection, is not violative of this proscription, unless done in the context of a "political campaign." But such a distinction was not made by the Court of Appeals in this case.

On May 1, 1978, the IRS issued a ruling[19] that alarmed a wide range of nonprofit organizations. This ruling—which was unquestionably a misapplication of the law—would have substantially broadened the scope of the proscription on political campaign activities applicable to charitable organizations.

However, in a rare reversal, the IRS revoked this ruling on June 2, 1978. In substitution, the IRS issued a new ruling[20] which properly attempts to confine impermissible "voter education" activities to those that are partisan in nature.

Generally, it was thought that dissemination of the views, voting records, and the like of candidates was permissible when total neutrality was observed. However, the IRS dashed this belief with the May, 1978, ruling when it announced that an organization cannot qualify for tax exemption as a "charitable" entity if it publishes in its newsletter the responses received from candidates for public office in an upcoming election, in reply to a questionnaire sent by the organization to all of the candidates. The Service, which expressly noted that the organization otherwise qualifies as an exempt educational entity, observed that the fact that the questions put to the candidates were on topics of concern to the organization's educational, research, and publishing activities and that the responses were published without editorial comment did not preclude deprivation of its tax exemption. The organization's newsletter is distributed to numerous individuals and organizations on its membership list and to others on request.

---

[14] Rev. Rul. 77-283, 1977-2 C.B. 72.

[15] See Chapter 15.

[16] E.g., opinion of law to Carter Inaugural Committee at BNA, *Daily Report for Executives* (No. 230) J-6 (Nov. 29, 1976).

[17] *Christian Echoes National Ministry, Inc.* v. *United States*, 470 F.2d 849 (10th Cir. 1972), cert. den., 414 U.S. 864 (1973).

[18] *Ibid.* at 856. Also *Monsky* v. *Commissioner*, 36 T.C.M. 1046 (1977); *Giordano* v. *Commissioner*, 36 T.C.M. 430 (1977).

[19] Rev. Rul. 78-160, 1978-1 C.B. 153.

[20] Rev. Rul. 78-248, 1978-1 C.B. 154.

In this ruling, the IRS stated that this prohibition on involvement in political campaigns "do[es] not refer only to participation or intervention with a partisan motive, but to *any* participation or intervention which affects voter acceptance or rejection of a candidate." Consequently, determined the Service, "the organization's solicitation and publication of candidates' views on topics of concern to the organization can reasonably be expected to influence voters to accept or reject candidates."

This unwarranted stretching of this proscription on campaign activities went far beyond the intent of Congress in enacting this provision and represented a significant departure from the previous administrative law. This ruling meant that nearly any activity involving a nonprofit organization and political candidates would cause the organization to lose or fail to acquire tax-exempt status. Thus, the import of this ruling extended not only to an organization's publishing activities but to similar programs involving political candidates such as seminars and debates, or the mere act of making facilities available to candidates. (On one point, the IRS stayed within the previously understood boundaries—unlike the Tenth Circuit Court of Appeals—by relating the ruling to candidates "in an upcoming election," which, however, raises the not unimportant question as to how much in the offing an election must be to not be "upcoming.")

Prior to the issuance of this ruling, it was generally believed that this type of "involvement" by an exempt organization in political campaign activities did not rise to the level of participation or intervention on behalf of a political candidate that is contemplated by this and similar proscriptions. This belief stemmed from the definition of the term "educational," which permits advocacy of particular positions or viewpoints as long as a full and fair exposition of the pertinent facts is also presented.[21] This understanding was furthered by the IRS in 1974 when it published a ruling allowing organizations operating a broadcasting station to provide equal air time to political candidates.[22] But the Service distinguished the 1974 ruling from its position in the May, 1978, ruling on the ground that, as respects the former, the organizations were required by the Federal Communications Act to provide free air time to political candidates, whereas, as respects the latter, there was no legal necessity to publish the candidates' statements.

This ruling would have particularly adversely impacted the political education organizations (such as the League of Women Voters Education Fund) which provide the public service of disseminating the views of political candidates on a nonpartisan basis. However, this type of activity was thought to have been outside the grasp of this prohibition on charitable groups, as exemplified by the enactment in 1969 of the law which explicitly excludes from the prohibition on public election activities by private foundations certain "nonpartisan" campaign activities.[23]

---

[21] Reg. § 1.501(c)(3)-1(d)(3)(1). See Chapter 7.

[22] Rev. Rul. 74-574, *supra*, n. 12.

The import of this ruling would have extended far beyond the voter education organizations and would likely have affected hundreds of issue-oriented groups that frequently publish but do not comment upon the views of political candidates. Moreover, this new position could have jeopardized the tax status of noncommercial broadcasting stations that are not subject to the federal equal time requirement. Even a school that permits candidates to participate in a public debate in its auditorium could, according to the effect of the May, 1978, ruling, have endangered its tax-exempt and charitable donee status.

There are, of course, First Amendment considerations involved in these restrictions. After the ruling was issued, there was a great outcry and a flurry of communications to the IRS, and there was much talk of a court challenge to the ruling.

The June 2, 1978, ruling contains two examples of "voter education" activities that a "charitable" organization may carry on without loss of tax exemption. These examples indicate that a charitable organization can (1) prepare and disseminate a compilation of the voting records of all members of Congress on a wide variety of major subjects, as long as there is no editorial comment and no approval or disapproval of the voting records is implied, and (2) publish the responses to its questionnaire on a wide variety of subjects from all candidates for an office, as long as no preference for a candidate is expressed. This second example presents a set of facts essentially identical to those in the May, 1978, ruling—but an opposite legal conclusion.

The June, 1978, ruling also contains two illustrations of prohibited activities: an organization may not (1) publish candidates' answers to questions that indicate a bias on the issues or (2) publish a voter guide reflecting the voting records of members of Congress on selected issues of interest to the organization. Probably the most troubling aspect of this ruling is the suggestion that the mere reproduction of candidates' views on a "narrow range" of issues (however defined) will somehow constitute an exemption-threatening activity.

Notwithstanding these latter two illustrations, the IRS subsequently ruled that a charitable organization may publish a newsletter containing the voting records of congressional incumbents on selected issues without prohibited involvement in political campaigns. The Service indicated that the format and content of the publication need not be neutral, in that each incumbent's votes and the organization's views on selected legislative issues can be reported, and the publication may indicate whether the incumbent supported or opposed the organization's view. Nonetheless, the IRS considered the following factors as demonstrating the absence of political campaign activity: (1) the voting records of all incumbents will be presented, (2) candidates for reelection will not be identified, (3) no comment will be made on an individual's overall qualifications for public office, (4) no statements expressly or impliedly endorsing or rejecting any incumbent as a candidate for public office will be offered, (5) no comparison of incumbents with other candidates will be made, (6) the organization will point out the inherent limitations of judging the qualifications of an incumbent on the basis of certain selected votes, by stating the need to consider such unrecorded matters as performance on subcommittees and constituent service, (7) the organization will not widely distribute its compilation of incumbents' voting records, (8) the publication will be distributed to the organization's normal readership (who number only a few thousand nationwide), and (9) no attempt will be made to target the publication toward particular areas in which elections are occurring nor to time the date of publication to coincide with an election campaign.[34]

---

[23] See Chapter ~~29.~~ 28

The organization named "Independent Sector" was, in recent years, engaged in a variety of activities in support of legislation that would enable taxpayers who do not itemize their deductions to nonetheless have the advantages of the charitable contribution deduction (the so-called "above-the-line" deduction).[35] It reported in its newsletter the votes in Congress on this legislation, along with copies of debate transcripts and a brief description of the background of each vote. This activity continued during the 1980 elections, with some of the candidates advocating passage of the legislation. Independent Sector also presented testimony on the subject to the platform committees of the Democratic and Republican parties.

The IRS ruled in 1980 that these lobbying activities did not constitute participation or intervention by Independent Sector in one or more political campaigns.[36] Of importance to the Service were the facts that the lobbying activities are engaged in without reference to the timing of political campaigns and that its newsletter is regularly published and not distributed widely throughout the electorate. The presentation of testimony before the platform committees of the political parties was also deemed to be a legislative effort, not a political effort.

On the heels of the letter ruling to Independent Sector approving publication of voting lists by charitable organizations, the IRS sanctioned the practice of some charitable groups of issuing "report cards" on the voting of legislators. But it took a lawsuit to reverse the original position of the IRS and bring the Service to this conclusion. At issue was the publication by the Office for Church in Society (OCS), an arm of the United Church of Christ, of lists of votes on selected issues, in which a legislator receives a "+" if his or her vote coincides with the OCS position and a "−" when it does not. The organization thereby injects into the presentation an element of editorial comment that was absent in the facts involved in the Independent Sector ruling and discouraged by the IRS in 1978. Nonetheless, the "report card" technique used by the OCS does not include any appeal for any candidate's election or defeat. The position of the IRS on this issue in general is that "in the absence of any expressions of endorsement for or opposition to candidates for public office, an organization may publish a newsletter containing voting records and its opinions on issues of interest to it provided that the voting records are not widely distributed to the general public during an election campaign or aimed, in view of all the facts and circumstances, towards affecting any particular elections."[27]

---

[34] Rev. Rul. 80-282, 1980-2 C.B. 178.

[35] See Chapter 1 § 5.

[36] Ruling dated September 4, 1980.

The case began when, in January of 1979, the OCS requested the IRS to rule that the publication of its report cards was not a form of prohibited participation or intervention in a political campaign. When the ruling was not forthcoming, the OCS filed its suit on First Amendment grounds. Nine days later, the ruling was issued as requested. As with the ruling issued to Independent Sector, the IRS conditioned its position on the fact that the publications will continue to be distributed to subscribers and will not be targeted to the locations of specific campaigns.[28]

Despite these dramatic turns of events, the fact remains that the IRS sought to resurrect the political campaign issue. Organizations should constantly monitor all of their activities in this area, because these rulings may have ramifications far beyond the types of activities discussed in them. Inasmuch as organizations function only through individuals, who have the freedom to engage in political activities, the law distinguishes between activities that are undertaken in conjunction with "official" responsibilities and those that are "personal"; only the former activities are relevant in assessing an organization's qualification for tax exemption in the face of political campaign efforts.[29] However, political activities of individuals (such as officers or members) will be imputed to the organization if it has, directly or indirectly, authorized or ratified the acts.[30]

§ 14.3 Educational or Political Activities

The government does permit a "charitable" organization to instruct the public on matters useful to the individual and beneficial to the community.[31] In carrying out such an "educational" purpose, an organization may cautiously enter the political milieu. Thus, organizations have been permitted to assemble and donate to libraries the campaign speeches, interviews, and other materials of an individual who was a candidate for a "historically important elective office,"[32] conduct public forums at which debates and lectures on social, political, and international questions are considered,[33] and conduct public forums involving congressional candidates, where there is a fair and impartial treatment of the candidates.[34] However, the organization will imperil its tax exemption if it solicits the signing or endorsing of a fair campaign practices code by political candidates.[35]

---

[27] GCM 38444.
[28] Ruling dated October 8, 1980.
[29] GCM 34631.
[30] GCM 33912.
[31] Reg. § 1.501(c)(3)-1(d)(3). See Chapter 7.

However, in performing activities such as these, the organization must present a sufficiently full and fair exposition of pertinent facts to permit the public to form its own opinion or conclusion independent of that presented by the organization, although the organization may also advocate a particular position or viewpoint.[36] Thus, while a charitable organization may seek to educate the public on patriotic, political, and civic matters and even alert the citizenry to the dangers of an extreme political doctrine, it may not do so by the use of disparaging terms, insinuations, innuendoes, and suggested implications drawn from incomplete facts.[37]

§ 14.4 Treatment of Activist Organizations

Aside from the types of activity traditionally considered by the federal tax laws to be "action" efforts—legislative and political campaign activities—there is a broad range of clearly "action" or "political" undertakings which may be described as the type of speech or activities sheltered by the First Amendment. These undertakings may be manifested in a variety of ways, such as writings, demonstrations, boycotts, strikes, picketing and litigation, all protected by the rights of free speech and association and the right to petition (assuming the absence of any illegal activities). These activities frequently give the IRS pause in evaluating the status of an organization as a "charitable" entity but, unless the activities may be fairly characterized as being impermissible lobbying or electioneering, there is no basis in the law concerning action organizations (as that term is used in its technical sense) for denying an organization engaging in such activities tax-exempt status or for revoking such an organization's tax-exempt status.

The position of the IRS on this point apparently is that this type of activity can be a permissible method by which to further tax-exempt purposes.[38] These activities will jeopardize tax exemption, however, where they are illegal or otherwise contrary to public policy.[39] Nonetheless, where an activity is legal, the IRS generally will not deem it contrary to public policy.[40]

---

[32] Rev. Rul. 70-321, 1970-1 C.B. 129.

[33] Rev. Rul. 66-256, 1966-2 C.B. 210.

[34] Rev. Rul. 86-95, ~~1986-2 C.B.~~ 1986-32 IRB 4

[35] Rev. Rul. 76-456, 1976-2 C.B. 151, super. Rev. Rul. 66-258, 1966-2 C.B. 213. Also Rev. Rul. 60-193, 1960-1 C.B. 195.

[36] Reg. § 1.501(c)(3)-1(d)(3). Also *Haswell* v. *United States*, 500 F.2d 1133, 1143–1145 (Ct. Cl. 1974), cert. den., 419 U.S. 1107 (1974).

[37] Rev. Rul. 68-263, 1968-1 C.B. 256.

[38] GCM 37858.

The tolerance of the courts in this area in general was classically illustrated by a federal district court finding that the anticonvention boycott orchestrated by the National Organization for Women, in states the legislatures of which had not ratified the proposed Equal Rights Amendment, was not in violation of antitrust laws, even though the boycott or concerted refusal to deal has been held to be an unlawful combination in restraint of trade.[41] Because the objective of NOW's convention boycott campaign was the ratification of the ERA, by means of demonstrating support and generating widespread publicity for the proposed amendment, the court found that the boycott activities "were not intended as punitive . . . and were not motivated by any type of anticompetitive purpose."[42] NOW was successful in asserting that the antitrust laws do not apply to boycotts that take place in a political rather than a commercial context.[43] The essence of the NOW case is summed up in one sentence from an article quoted by the court: "There are areas of our economic and political life in which the precepts of antitrust must yield to other social values."[44]

Coincidentally, at the same time the NOW litigation was unfolding, the IRS had before it the tax status of an organization that conducts a consumer boycott. Prior to the decision in the NOW case, the IRS concluded that the organization, which conducts a national campaign against the purchase of products by companies that manufacture infant formula and market it in developing countries by means of allegedly unethical business practices, could not qualify as a charitable entity because it is an "action" organization. Consequently, the organization took the matter into court,[45] but just before the case reached the briefing stage, the IRS suddenly reversed its position and issued a favorable ruling, thereby mooting the case.

Presumably, therefore, the case stands as precedent for the proposition that an organization may conduct a boycott in furtherance of charitable ends.[46] The operative legal principle appears to be that, while the conduct of a boycott may not itself be an exempt function, a boycott can further an exempt purpose and thereby lead to charitable status. As the IRS has recognized, "[t]he performance of a particular activity that is not inherently charitable may nonetheless further a charitable purpose [and the] . . . overall result in any given case is dependent on why and how that activity is actually being conducted."[47]

---

[39] See Chapter 4 § 3.

[40] GCM 37858.

[41] *State of Missouri* v. *National Organization for Women, Inc.*, 467 F.Supp. 289 (W.D. Mo. 1978).

[42] *Ibid.* at 296.

[43] Also *Eastern Railroad Presidents Conference* v. *Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961); *Register of Wills for Baltimore City* v. *Cook*, 216 A.2d 542 (Ct. App. Md. 1966).

[44] Handler, "Annual Review of Antitrust Developments," 71 *Yale L.J.* 75, 88 (1961).

[45] *The Infant Formula Action Coalition* v. *United States* (D.D.C. No. 79-0129).

[46] Some organizations, already possessing IRC § 501(c)(3) classification, engage in consumer boycotts (relating to, for example, the purchase of tuna, products that exploit animals, and products produced in whaling nations) but *The Infant Formula Action Coalition* case, *supra*, n. 45, involved an organization that conducts a boycott as its primary activity and that had its tax status reviewed by the IRS at the outset of its existence.

Moreover, the IRS has formally conceded that an otherwise tax-exempt charitable organization can further its exempt purposes by instituting litigation, even where the organization employs private attorneys to represent it in bringing and maintaining the litigation. The Service does insist, however, that an organization's litigation activities be a "reasonable means" of accomplishing its tax-exempt purposes, and that the program of litigation not be illegal, contrary to a clearly defined and established public policy, or violative of express statutory provisions.[48]

This means-to-an-end principle thus characterizes activities like demonstrations, boycotts, and litigation as "neutral" activities—from a federal tax standpoint—and allows the tax status of the organization conducting them to depend on its ability to show how tax-exempt purposes are thereby furthered. (In some instances, the IRS has publicly recognized the tax-exempt status of organizations engaging in this type of activity, such as litigation conducted by public interest law firms.)

This principle has also been recognized in the courts. As the U.S. Tax Court recently noted, "the purpose towards which an organization's activities are directed, and not the nature of the activities themselves, is ultimately dispositive of the organization's right to be classified as a section 501(c)(3) organization."[49] In a similar case, the same court found that an activity (sale of handicrafts) was neither an exempt purpose nor a nonexempt purpose but "an activity carried on by . . . [the organization] in furtherance of its exempt purposes."[50]

The U.S. Supreme Court has applied this principle in an analogous context. Perhaps the most applicable of the Court's opinions is the holding that litigation activities as conducted in the public interest context of that case are modes of expression and association protected by constitutional law and may not be barred by state authority to regulate the legal profession.[51] The Court distinguished this type of litigation from that normally instituted to resolve private differences, stating that the former is "a means for achieving lawful objectives."[52] In that case, litigation activities were perceived as neutral activities, engaged in as a means for accomplishment of the organization's ends. Likewise, boycotts, demonstrations, and the like can serve as vehicles for carrying forward charitable purposes. As the Court has repeatedly observed, the First Amendment protects advocacy, certainly of lawful ends, against governmental intrusion.[53]

---

[47] Rev. Rul. 69-572, 1969-2 C.B. 119.

[48] Rev. Rul. 80-278, 1980-2 C.B. 175. The IRS, in Rev. Rul. 80-279, 1980-2 C.B. 176, took a like stance with respect to an organization that conducts mediation of international environmental disputes.

[49] *Pulpit Resource* v. *Commissioner*, 70 T.C. 594 (1978).

[50] *Aid to Artisans, Inc.* v. *Commissioner*, 71 T.C. 202 (1978).

[51] *N.A.A.C.P.* v. *Button*, 371 U.S. 415 (1963).

A court has specifically held that litigation is an "appropriate vehicle for an organization to accomplish" its tax-exempt purpose, in a case involving the tax-exempt status of an organization that provides legal assistance to employees whose rights are violated under compulsory unionism arrangements.[54]

In one case, the IRS had taken the position that engaging in proxy contest activities was not a charitable activity. There was no dispute over the fact that proxy contests are not inherently charitable or educational endeavors. However, upon review, the court placed the organization's activities in context, that is, in light of its overall purposes.[55] The court recognized that the purpose of the organization "is to make corporate management, and thus corporations, responsible."[56] The court continued:

> It is only reasonable that corporations begin to realize that they have duties beyond simply making money for their stockholders. A corporation does not exist in a vacuum, but is part of the community for better or for worse. In the past, it has been for worse. Large corporations have contributed to many of the social problems affecting the community both directly, in hiring practices, effects on the environment, non-compliance with regulations, indifference to the consumer safety, etc. and indirectly through use of their economic power in socially irresponsible ways. As a member of the community, it is incumbent upon corporations to use their substantial economic power for the community good, rather than solely for self-enrichment, at the community's expense.

---

[52] *Ibid*. at 429.

[53] E.g., *Thomas* v. *Collins*, 323 U.S. 516 (1945); *Herndon* v. *Lowry*, 301 U.S. 242 (1937). Also *Pratt* v. *Robert S. Odell & Co*., 122 P.2d 684, 692 (D.C. App. Cal. 1942), where it was held that a corporation may expend funds in the prosecution of litigation to which it is not a party where the expenditure is a means for furthering its objects; and *Register of Wills for Baltimore City* v. *Cook*, *supra*, n. 43 at 546, where it was held that advocacy of passage of the Equal Rights Amendment is one method of accomplishing the charitable objectives of a tax-exempt trust. In this context, it should be noted that, in *Village of Schaumburg* v. *Citizens for a Better Environment*, 444 U.S. 620 (1980), the Supreme Court held that acts of fund raising are among the most protected forms of free speech.

[54] *National Right to Work Legal Defense and Education Foundation, Inc*. v. *United States*, 487 F.Supp. 801 (E. D. N. Car. 1979). Cf. *Retired Teachers Legal Defense Fund, Inc*. v. *Commissioner*, 78 T.C. 280 (1982).

[55] *Center on Corporate Responsibility, Inc*. v. *Shultz*, 368 F.Supp. 863 (D.D.C. 1973).

[56] *Ibid*. at 874, n. 21.

> The need for a swift re-orientation of the corporate perspective to its community responsibilities is imperative. The general public is in no financial organizational or power position to undertake the task with any effectiveness.[57]

With that as background, the court in this case discussed the proxy voting process and its impact on corporate management. After commenting that proposals to promote socially responsible programs and policies may not be voted in by stockholders, the court concluded:

> But the questions will have been raised, the shareholders will have been educated to the wider horizon, and the seed may have been planted for future change that will require the corporation to assume some of its duties as a member of the community. The beneficiary of this activity and educational process to promote socially responsible corporations will be the public. . . .
>
> As the Court views them, proxy contests appear to be the more direct and effective instrument of achieving the Plaintiff's purposes, and when conducted in the public interest, as the Plaintiff has done, they are charitable activities, in that they are the instruments (both legal and not against public policy) by which the charitable purposes are accomplished for the public good.[58]

It may be anticipated that this new breed of action—perhaps better put, "activist"—organizations will be proliferating. The consumerism movement, public reaction to nuclear power plant accidents and fuel shortages, and similar developments are likely to spawn new forms of activist groups. Unlike some of their forebears, these groups will conduct heavy direct mailing efforts, both for dissemination of information and for fund raising. Thus, their tax and postal status will be of great concern to them. It will also be of concern to the IRS and the Service's natural reluctance to grant tax preferences to unorthodox groups or those with unorthodox practices will readily manifest itself. But, with easy access to the courts, with the courts' steadiness in protecting speech, petition, and association rights, and with the fluorishing of the "means-to-an-end" doctrine, these activist organizations should be able to secure their desired federal law status.

---

[57] *Ibid*. at 874–875, n. 21.

[58] *Ibid*. at 875, n. 21. In general, Caron and Dessingue, "IRC § 501(c)(3): Practical and Constitutional Implications of 'Political' Activity Restrictions," II *J. of Law & Politics* (No. 1) 169 (1985)/ Crumplar, "Tax Consequences of Political Activity by Religious Organizations," V *The Christian Lawyer* (No. 2) 29 (1975); Garrett, "Federal Tax Limitations on Political Activities of Public Interest and Educational Organizations," 59 *Geo. L. J*. 561 (1971); Note, "Political Activity and Tax-Exempt Organizations Before and After The Tax Reform Act of 1969," 38 *G. W. U. L. Rev*. 1114 (1970); Amer. Ent. Inst., *Political Activities of Colleges and Universities* (1970); Lehrfeld, "How much 'politicking' can a charitable organization engage in?," 20 *J. Tax*. 236 (1968); Boehm, "Political Expenditures by Tax-Exempt Organizations," 14 *Prac. Law*. 13 (1968); Note, "Income Tax Disadvantages of Political Activities," 57 *Col. L. Rev*. 273 (1957).

§ 14.5 Taxation of Political Activities

An organization that engages in political campaign activities but not to the degree that its tax exemption is endangered may nonetheless be required to pay a special tax. While this presumably would not be possible for a charitable organization, it could occur in the case of an organization such as a social welfare group.[59] Charitable organizations may nonetheless engage in activities that are considered "political" activities[60]—but not "political campaign" activities and, as a result, attract this tax.

In the case of most tax-exempt organizations,[61] where there is an expenditure for a political activity, this tax will likely apply. The tax is determined by computing an amount equal to the lesser of the organization's net investment income[62] for the year involved or the amount expended for the political end. This amount must be treated as "political organization taxable income"[63] and taxed[64] at the highest corporate rates.[65]

19

[59] Rev. Rul. 81-95, 1981-1 C.B. 332.
[60] IRC § 527(e)(2). In general, see Chapter 20 § 18.
[61] That is, those described in IRC § 501(c).
[62] IRC § 527(f)(2).
[63] IRC § 527(c).
[64] IRC § 527(b).
[65] IRC § 11(b).

Chairman **Pickle**. Thank you, Mr. Hopkins. Now the Chair will ask the Associate Director of the GAO to report and make such statement as you like. Ms. Stathis.

STATEMENT OF JENNIE S. STATHIS, ASSOCIATE DIRECTOR, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY HELEN FAUNTLEROY, EVALUATOR, AND ANDREA KOLE, COUNSEL, OFFICE OF GENERAL COUNSEL

Ms. **Stathis**. Good morning, Mr. Chairman. We also are pleased to be here to help in your inquiry.

As you mentioned in your opening statement, our statement is based on work that we did for the subcommittee in response to your request for information on these activities.

Our work showed that Congress has enacted legislation to restrict lobbying and political activities of tax-exempt organizations; that while IRS data on the nature and extent of such activities are limited, available data indicate that certain types of tax-exempt organizations are more likely to engage in these activities than others.

IRS does not have a separate compliance program to monitor these activities, and the IRS form 990 is the form which provides limited information on these activities of tax-exempt organizations.

The next part of my statement is a summary of the current rules relating to lobbying and political activities. Since Mr. Hopkins has covered so many of those, I will not go through that section in detail. It does provide the current definition of lobbying, and the current definition of political activity.

Skipping over to the section on tax-exempt organizations most likely to engage in the activity, IRS statistics indicate that there are over 800,000 section 501(c)(3) tax-exempt organizations, and this does not include an unknown number of religious organizations which did not or were not required to apply for tax-exempt status.

According to IRS program officials, organizations most likely to engage in lobbying or political activities are the section 501(c) public charities, the social welfare organizations, labor unions, business leagues, war veteran groups, and the section 527 political organizations.

We have an appendix to the statement which has a brief description of those organizations.

Now we found that complete data on the nature and extent of lobbying and political activities by tax-exempt organizations are not available. The data on planned activities reported to IRS on the organizations' applications for tax-exempt status indicate that less than 1 percent of these organizations planned to engage in lobbying or political activities.

The data indicate that most of these activities by section 501(c) organizations were concentrated among the 501(c)(4) social welfare organizations, the 501(c)(5) labor unions, and the 501(c)(6) business leagues.

As of October 1986, there were about 253,000 organizations in those three categories, and we have an appendix that provides specific numbers on those.

IRS does not have a separate compliance program to monitor the lobbying and political activities of tax-exempt organizations. The Office of the Assistant Commissioner for Employee Plans and Exempt Organizations is responsible for monitoring these activities as part of its overall efforts to administer IRS programs pertaining to tax-exempt organizations.

The Office issues revenue rulings, provides overall guidance on lobbying and political activities, maintains limited statistical data on lobbying and political activities, and identifies and reviews these activities as part of its routine compliance examinations.

As Mr. Schulze noted in his opening statement, in fiscal year 1986 IRS examined more than 20,000, or about 5 percent of the tax-exempt organizations' returns. Lobbying or political activity was the principal issue in over 400 of them, or about 2 percent of the returns examined.

As a result of these examinations, IRS revoked the exempt status of 25 organizations, because of general or direct lobbying activities, modified the status of 24 organizations because of direct lobbying and political activities, and changed the tax liability of 11 organizations because of political activities and grassroots lobbying.

In addition to routine examinations, IRS also reviews income and expenditures of some tax-exempt organizations that engage in political activities and report taxable income. Such organizations are required to report taxable income on the form 1120. In 1986 IRS screened about 700 of these forms for audit potential and examined 145 of them.

Statistics were not available on the reasons for and results of those examinations.

The last section of our statement is on the form 990. That is the annual information return filed by certain tax-exempt organizations to provide IRS information about their activities. That form is available for public use. It contains a variety of information, including the type of organization and income and expense schedule, a balance sheet, program services rendered, names of officers and directors, and other activity-oriented information.

We have included a copy of that form as an appendix to the statement.

The form and its schedule A provide some information related to lobbying and political activities, but that information is limited.

For example, the organizations that file the forms are required to report their expenditures related to political activities. Also section 501(c)(3), (5) and (6) organizations are required to report their expenditures related to lobbying. Except for section 501(c)(3) organizations, the form does not require the organization to identify the nature of the lobbying or political activities.

Further, not all tax-exempt organizations are required to file the form 990. Therefore, those forms cannot be used to obtain a complete picture of the nature and extent of lobbying and political activities.

So to sum up our statement, there are over 800,000 tax-exempt organizations. Congress has restricted their lobbying and political activities. Available statistics do not clearly indicate the percentage of them that engage in lobbying and political activities, and IRS has no special compliance program to monitor these activities, but reviews them as part of routine examinations.

And finally, the form 990 contains some, but limited, information on these activities.

That concludes my prepared statement. I would like to introduce to the subcommittee on my left Ms. Helen Fauntleroy of my staff who was responsible for putting the fact sheet together for the subcommittee, and on my right is Andrea Kole, counsel from GAO's Office of General Counsel.

[The prepared statement and attachment follow:]

Statement of
Jennie S. Stathis, Associate Director
General Government Division

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here this morning to assist the Subcommittee in its inquiry regarding the lobbying and political activities of tax-exempt organizations. Our statement is based on work we did in response to your November 1986 request for information on such activities. Our work showed that (1) Congress has enacted legislation to restrict the lobbying and political activities of tax-exempt organizations; (2) while IRS' data on the nature and extent of such activities are limited, the available data indicate that certain types of tax-exempt organizations are more likely to engage in lobbying and political activities than others; (3) IRS does not have a separate compliance program to monitor such activities; and (4) IRS Form 990 provides limited information on the lobbying and political activities of tax-exempt organizations (GAO/GGD-87-32FS, Jan. 16, 1987).

RULES RELATED TO LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

Most tax-exempt organizations are exempt under section 501(c) of the Internal Revenue Code. This section contains 25 categories of tax-exempt organizations, including section 501(c)(3) charitable, educational, and religious organizations; 501(c)(4) social welfare organizations; and 501(c)(5) labor unions. Other sections of the Internal Revenue Code also provide exempt status for political organizations, various cooperatives, and other organizations.

The Internal Revenue Code section 4911(d) defines "lobbying" or "influencing legislation" as

> "(A) any attempt to influence any legislation through an attempt to affect the opinions of the general public or any segment thereof, and (B) any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation."

Treasury regulation defines "political activity" as all direct or indirect participation or intervention in any political campaign on behalf of or in opposition to any candidate for public office, including publication or distribution of written statements on behalf of or in opposition to such a candidate.

In the Revenue Act of 1934 and in subsequent legislation, Congress restricted the lobbying and political activities of tax-exempt organizations. Under current law, for example, section 501(c)(3) organizations are prohibited from engaging in political activities. Also, public charities organized under this section must limit their lobbying activities to an insubstantial portion of their total activities. They may elect to have insubstantial lobbying expenses governed by specific dollar expenditure limitations pursuant to section 501(h). Churches, private foundations, and certain other organizations may not elect this expenditure test. Further, an excise tax is placed on the lobbying activities of private foundations exempt under this same section. Other exempt organizations are subject to different, but generally less restrictive, rules relating to lobbying and political activities. Appendix I provides information on the major prohibitions on and tax consequences of lobbying and political activities by selected tax-exempt organizations.

TAX-EXEMPT ORGANIZATIONS MOST LIKELY TO ENGAGE IN LOBBYING AND POLITICAL ACTIVITY

IRS statistics indicate that there are over 800,000 section 501(c) tax-exempt organizations. This does not include an unknown number of religious organizations which did not, or were not required to, apply for tax-exempt status. According to IRS program officials, organizations found most likely to engage in lobbying and/or political activities are section 501(c) public charities, social welfare organizations, labor unions, business leagues, war veteran groups, and section 527 political organizations. Appendix II of this statement presents a brief description of each of these types of organizations.

Complete data on the nature and extent of lobbying and political activities by tax-exempt organizations are not available. However, data on planned activities reported to IRS on organizations' applications for tax-exempt status indicate that less than 1 percent of these organizations engage in lobbying and/or political activities. The data indicate that most of the lobbying and/or political activities by section 501(c) organizations seem to be concentrated among section 501(c)(4) social welfare organizations, section 501(c)(5) labor unions, and section 501(c)(6) business leagues. As of October, 1986, there were about 253,000 organizations in these three categories. Appendix III of this statement presents the specific numbers of tax-exempt organizations in categories most likely to engage in lobbying or political activities.

IRS' EFFORTS TO MONITOR LOBBYING AND POLITICAL ACTIVITIES

IRS does not have a separate compliance program to monitor the lobbying and political activities of all tax-exempt organizations. The Office of the Assistant Commissioner (Employee Plans and Exempt Organizations) is responsible for monitoring these activities as part of its overall efforts to administer IRS programs pertaining to tax-exempt organizations. The office issues revenue rulings and provides overall guidance on lobbying and political activities, maintains limited statistical data on lobbying and political activities, and identifies and reviews lobbying and political activities as part of routine compliance examinations.

In fiscal year 1986, IRS examined 20,084, or about 5 percent, of tax-exempt organizations' returns, and lobbying or political activity was the principal issue in 432, or about 2 percent, of the returns examined. As a result of these examinations, IRS revoked the exempt status of 25 organizations because of general lobbying activities, modified the status of 24 organizations because of general lobbying and political activities, and changed the tax liability of 11 organizations because of political activities and grass roots lobbying.

In addition to routine examinations, IRS also reviews the income and expenditures of some tax-exempt organizations engaging in political activities and reporting taxable income. Such tax-exempt organizations are required to report taxable income on Form 1120-POL--U.S. Income Tax Return for Certain Political Organizations. In 1986, IRS screened about 700 of these forms for audit potential and examined 145 of them. Statistics are not readily available on the reasons for and results of these examinations.

FORM 990 PROVIDES LIMITED INFORMATION ON LOBBYING AND POLITICAL ACTIVITIES

Form 990, Return of Organization Exempt From Income Tax, is an annual information return filed by certain tax-exempt organizations to provide IRS with information about their activities. This form is available for public use. Form 990 contains a variety of information, including the type of organization, an income and expense schedule, a balance sheet, the program services rendered, the names of officers and directors, and other activity-oriented information. Appendix IV is a copy of Form 990 and its related Schedule A.

Form 990 and its related Schedule A provide some information related to lobbying and political activities, but this information is limited. For example, the organizations that file the forms are required to report their expenditures related to political activities. Also, section 501(c)(3), (5), and (6) organizations are required to report their expenditures related to lobbying. Except for section 501(c)(3) organizations, the form does not require the organization to identify the nature of the lobbying or political activities. Further, not all tax-exempt organizations are required to file a Form 990. Therefore, these forms cannot be used to obtain a complete overview of the nature and extent of the lobbying and political activities of the tax-exempt community.

- - - -

In sum, there are over 800,000 tax-exempt organizations, not including some religious organizations, and Congress has restricted their lobbying and political activities. Available IRS statistics do not clearly indicate the percentage of tax-exempt organizations that engage in lobbying and/or political activities. IRS has no special compliance program to monitor lobbying and political activities, but reviews such activities as part of routine examinations. IRS Form 990 contains limited information on the lobbying and political activities of tax-exempt organizations.

This concludes my prepared statement. We would be pleased to respond to your questions.

MAJOR PROHIBITIONS ON AND TAX CONSEQUENCES OF LOBBYING AND POLITICAL ACTIVITY BY SELECTED TAX-EXEMPT ORGANIZATIONS

	Section 501(c)(3) public charities not electing section 501(h)	Section 501(c)(3) public charities electing section 501(h)	Section 501(c)(3) private foundations	Section 501(c)(4) social welfare organizations Section 501(c)(5) labor unions Section 501(c)(6) business leagues Section 501(c)(19) veterans groups	Section 527 political organizations
Prohibited lobbying activities	Substantial lobbying is prohibited. Lobbying activities include (1) any attempt to effect general public opinion or any segment thereof, and (2) any attempt to influence legislation through communication with legislators or government officials who help formulate legislation.	Lobbying beyond specific dollar amounts is prohibited. Lobbying activities include (1) any attempt to effect general public opinion or any segment thereof, and (2) any attempt to influence legislation through communication with legislators or government officials who help formulate legislation.	Substantial lobbying is prohibited, and most lobbying related expenditures are heavily taxed. Willful repeated acts or a willful and flagrant act of lobbying could cause termination of the organization's private foundation status.	Lobbying is not prohibited and can be the primary means of achieving the exempt purpose.	Lobbying is permitted, but it cannot be the primary purpose of the organizaiton.
Prohibited political activities	All direct or indirect participation or intervention in any political campaign on behalf of or in opposition to any candidate for public office, including publication or distribution of written statements on behalf of or in opposition to such a candidate, is prohibited.	All direct or indirect participation or intervention in any political campaign on behalf of or in opposition to any candidate for public office, including publication or distribution of written statements on behalf of or in opposition to such a candidate, is prohibited.	All direct or indirect participation or intervention in any political campaign on behalf of or in opposition to any candidate for public office, including publication or distribution of written statements on behalf of or in opposition to such a candidate, is prohibited. All such acts are heavily taxed. Unbiased voter registration activities are not considered to be political activities. Expenditures related to nonpartisan and wide ranging voter registration activities are not taxable. Expenditures related to other voter registration activities are taxable.	Political activity cannot be the organization's primary purpose. According to an IRS publication, this is also IRS' position with respect to section 501(c)(5) labor unions. Political activity which prevents the organization from primarily engaging in activities that promote the exempt purpose is prohibited.	None.

MAJOR PROHIBITIONS ON AND TAX CONSEQUENCES OF LOBBYING AND POLITICAL ACTIVITY BY SELECTED TAX-EXEMPT ORGANIZATIONS

	Section 501(c)(3) public charities not electing section 501(h)	Section 501(c)(3) public charities electing section 501(h)	Section 501(c)(3) private foundations	Section 501(c)(4) social welfare organizations Section 501(c)(5) labor unions Section 501(c)(6) business leagues Section 501(c)(19) veterans groups	Section 527 political organizations
Tax consequences	Contributions are deductible for donors unless funds are earmarked for lobbying. Substantial lobbying causes revocation of exempt status. There are no specific criteria for substantial lobbying. The facts and circumstances of each individual case determines if substantial lobbying is taking place. Expenditures for nonpartisan analysis, and testimony at the request of a legislative body, are not taxable as lobbying expenditures.	Contributions are deductible for donors unless funds are earmarked for lobbying. Under the section 501(h) election, permitted lobbying expenditures are calculated on a sliding scale and are equal to 20 percent of the first $500,000 of exempt purpose expenditures, plus 15 percent of the second $500,000, plus 10 percent of the third $500,000, plus 5 percent of any additional expenditures. The maximum non-taxable amount that can be spent on general lobbying is $1 million. The tax rate on expenditures that exceed this ceiling is 25 percent. Grass roots lobbying is limited to 25 percent of the lobbying nontaxable amount. Exempt status will be revoked if excess expenditures continue over a 4-year period. Expenditures for nonpartisan analysis, and testimony at the request of a legislative body, are not taxable as lobbying expenditures.	Contributions are deductible for donors unless funds are earmarked for lobbying. A 10 percent excise tax is initially imposed on lobbying expenditures. If such expenditures are not corrected within the taxable period, a 100 percent excise tax is imposed on the lobbying expenditures. A 50 percent excise tax on lobbying expenditures can be imposed on foundation management if it refuses to agree to part or all of the correction. Expenditures for nonpartisan analysis, and testimony at the request of a legislative body, are not taxable as lobbying expenditures.	Contributions are generally not deductible as charitable contributions.a/ Membership dues may be deductible as ordinary and necessary business expenses, except those used for political action or grassroots lobbying. Membership dues used for lobbying not germane to the exempt purpose are not deductible by members of section 501(c)(5) and (6) organizations. Any amounts spent by these section 501(c) organizations for political purposes are taxed at the highest corporate rate. These section 501(c) organizations can establish separate segregated funds to receive political contributions and make political expenditures. Seperate segregated funds are taxed in the same manner as section 527 political organizations.	Business deductions are not allowed for any contributions to a political party, group, committee, or candidate. Investment income is taxed at the highest corporate tax rate. If a principal campaign committee of a candidate for Congress is designated, investment income will be taxed at the regular corporate rate.

Source: Internal Revenue Code and Regulations

a/ Complex rules govern the deductibility of contributions to some section 501(c) organizations. For example, taxpayers can deduct contributions made to section 501(c)(19) war veteran organizations even though no lobbying limitation has been placed on these organizations.

TYPES OF TAX-EXEMPT ORGANIZATIONS MOST LIKELY TO ENGAGE IN LOBBYING AND/OR POLITICAL ACTIVITIES

Organization category	Type of Tax-Exempt Organization
Section 501(c)(3)	Entities organized and operated exclusively for religious, charitable, scientific, testing for public safety, literacy, or educational purposes, or for the prevention of cruelty to children or animals, or to foster amateur sports.
Section 501(c)(4)	Civic leagues or organizations operated exclusively for the promotion of social welfare and local associations of employees devoted to charitable, educational, or recreational purposes.
Section 501(c)(5)	Labor, agricultural, or horticultural organizations operated to provide education or instruction on improving working conditions and products.
Section 501(c)(6)	Business leagues, chambers of commerce, real estate boards, professional football leagues, etc., established to improve business conditions.
Section 501(c)(19)	Post or organization established to promote the welfare of past or present members of the Armed Forces.
Section 527	Political organizations established to accept contributions and make expenditures for a political candidate.

NUMBER OF TAX-EXEMPT ORGANIZATIONS IN CATEGORIES MOST LIKELY TO ENGAGE IN LOBBYING AND/OR POLITICAL ACTIVITIES AS OF OCTOBER 31, 1986[a]

IRC section	Number of organizations	Percent of total
501(c)(3)[b]	371,395[c]	44
501(c)(4)	126,664	15
501(c)(5)	71,679	9
501(c)(6)	54,654	6
501(c)(19)	24,310	3
All other 501(c) organizations	193,264	23
Total 501(c) organizations	841,966	100

Source: IRS Exempt Organization/Business Master File.

[a] IRS does not have statistics on the number of section 527 political organizations.

[b] Excludes religious organizations which did not apply for tax-exempt status.

[c] According to an IRS program official, this figure includes about 37,000 private foundations.

Form **990**

Department of the Treasury
Internal Revenue Service

Return of Organization Exempt From Income Tax

Under section 501(c) (except black lung benefit trust or private foundation) of the Internal Revenue Code or section 4947(a)(1) trust

Note: You may be required to use a copy of this return to satisfy state reporting requirements. See instruction D.

OMB No 1545-0047

1986

For the calendar year 1986, or fiscal year beginning , 1986, and ending , 19

Use IRS label. Otherwise, please print or type.	Name of organization	**A Employer identification number** (see instruction L)
	Address (number and street)	**B State registration number** (see instruction D)
	City or town, state, and ZIP code	C Section 4947(a)(1) trusts filing this form in lieu of Form 1041, check here ▶ ☐ (see instruction C10)

D Check type of organization—Exempt under section ▶ ☐ 501(c) ( ) (insert number), OR ▶ ☐ section 4947(a)(1) trust

E Accounting method: ☐ Cash ☐ Accrual ☐ Other (specify) ▶

Check here if application for exemption is pending ▶ ☐

F Is this a group return (see instruction J) filed for affiliates? ☐ Yes ☐ No

If "Yes," enter the number of affiliates for which this return is filed ____

Is this a separate return filed by a group affiliate? ☐ Yes ☐ No

G If "Yes" to either, give four-digit group exemption number (GEN) ▶

H ☐ Check here if your gross receipts are normally not more than $25,000 (see instruction B11). You do not have to file a completed return with IRS but should file a return without financial data if you were mailed a Form 990 Package (see instruction A). Some states may require a completed return.

I ☐ Check here if gross receipts are normally more than $25,000 and line 12 is $25,000 or less. Complete Parts I (except lines 13-15), III, IV, VI, and VII and only the indicated items in Parts II and V (see instruction I). If line 12 is more than $25,000, complete the entire return.

501(c)(3) organizations and 4947(a)(1) trusts must also complete and attach Schedule A (Form 990). (See instructions.)

Part I Statement of Support, Revenue, and Expenses and Changes in Fund Balances

					(A) Total	These columns are optional—see instructions (B) Unrestricted/ Expendable	(C) Restricted/ Nonexpendable
Support and Revenue	1	Contributions, gifts, grants, and similar amounts received:					
	a	Direct public support					
	b	Indirect public support					
	c	Government grants					
	d	Total (add lines 1a through 1c) (attach schedule—see instructions)					
	2	Program service revenue (from Part IV, line f)					
	3	Membership dues and assessments					
	4	Interest on savings and temporary cash investments					
	5	Dividends and interest from securities					
	6a	Gross rents					
	b	Minus: rental expenses					
	c	Net rental income (loss)					
	7	Other investment income (Describe ▶)					
	8a	Gross amount from sale of assets other than inventory	Securities	Other			
	b	Minus: cost or other basis and sales expenses					
	c	Gain (loss) (attach schedule)					
	9	Special fundraising events and activities (attach schedule—see instructions):					
	a	Gross revenue (not including $________ of contributions reported on line 1a)					
	b	Minus: direct expenses					
	c	Net income (line 9a minus line 9b)					
	10a	Gross sales minus returns and allowances					
	b	Minus: cost of goods sold (attach schedule)					
	c	Gross profit (loss)					
	11	Other revenue (from Part IV, line g)					
	12	Total revenue (add lines 1d, 2, 3, 4, 5, 6c, 7, 8c, 9c, 10c, and 11)					
Expenses	13	Program services (from line 44, column (B)) (see instructions)					
	14	Management and general (from line 44, column (C)) (see instructions)					
	15	Fundraising (from line 44, column (D)) (see instructions)					
	16	Payments to affiliates (attach schedule—see instructions)					
	17	Total expenses (add lines 16 and 44, column (A))					
Fund Balances	18	Excess (deficit) for the year (subtract line 17 from line 12)					
	19	Fund balances or net worth at beginning of year (from line 74, column (A))					
	20	Other changes in fund balances or net worth (attach explanation)					
	21	Fund balances or net worth at end of year (add lines 18, 19, and 20)					

For Paperwork Reduction Act Notice, see page 1 of the Instructions.

Form 990 (1986)

Form 990 (1986) Page 2

Part II **Statement of Functional Expenses**

All organizations must complete column (A). Columns (B), (C), and (D) are required for most sections 501(c)(3) and (c)(4) organizations and 4947(a)(1) trusts but optional for others. (See instructions.)

Do not include amounts reported on lines 6b, 8b, 9b, 10b, or 16 of Part I.		(A) Total	(B) Program services	(C) Management and general	(D) Fundraising
Expenses	22 Grants and allocations (attach schedule)			▨	▨
	23 Specific assistance to individuals			▨	▨
	24 Benefits paid to or for members			▨	▨
	25 Compensation of officers, directors, etc.				
	26 Other salaries and wages				
	27 Pension plan contributions				
	28 Other employee benefits				
	29 Payroll taxes				
	30 Professional fundraising fees		▨	▨	
	31 Accounting fees				
	32 Legal fees				
	33 Supplies				
	34 Telephone				
	35 Postage and shipping				
	36 Occupancy				
	37 Equipment rental and maintenance				
	38 Printing and publications				
	39 Travel				
	40 Conferences, conventions, and meetings				
	41 Interest				
	42 Depreciation, depletion, etc. (attach schedule)				
	43 Other expenses (itemize): a				
	b				
	c				
	d				
	e				
	f				
	44 Total functional expenses (add lines 22 through 43) Organizations completing columns B-D, carry these totals to lines 13-15.				

Part III **Statement of Program Services Rendered**

	List each program service title on lines a through d; for each, identify the service output(s) or product(s), and report the quantity provided. Enter the total expenses attributable to each program service and the amount of grants and allocations included in that total. (See instructions for Part III.)	Expenses (Optional for some organizations—see instructions)
a	(Grants and allocations $)	
b	(Grants and allocations $)	
c	(Grants and allocations $)	
d	(Grants and allocations $)	
e	Other program service activities (attach schedule) (Grants and allocations $)	
f	Total (add lines a through e) (should equal line 44, column (B))	

Part IV **Program Service Revenue and Other Revenue (State Nature)**

	Program service revenue	Other revenue
a Fees from government agencies		
b		
c		
d		
e		
f Total program service revenue (enter here and on line 2)		▨
g Total other revenue (enter here and on line 11)		

Part V **Balance Sheets** If line 12 or Column (B) of line 59 is more than $25,000, complete the entire balance sheet. If line 12, Part I, and Column (B) of line 59 are $25,000 or less, you may complete only lines 59, 66, 74, and 75. See instructions.

Note: **Columns (C) and (D) are optional.** *Columns (A) and (B) must be completed to the extent applicable. Where required, attached schedules should be for end-of-year amounts only.*	(A) Beginning of year	End of year		
		(B) Total	(C) Unrestricted/ Expendable	(D) Restricted/ Nonexpendable
Assets				
45 Cash—non-interest bearing				
46 Savings and temporary cash investments				
47 Accounts receivable ▶ ______ minus allowance for doubtful accounts ▶ ______				
48 Pledges receivable ▶ ______ minus allowance for doubtful accounts ▶ ______				
49 Grants receivable				
50 Receivables due from officers, directors, trustees, and key employees (attach schedule)				
51 Other notes and loans receivable ▶ ______ minus allowance for doubtful accounts ▶ ______				
52 Inventories for sale or use				
53 Prepaid expenses and deferred charges				
54 Investments—securities (attach schedule)				
55 Investments—land, buildings and equipment: basis ▶ ______ minus accumulated depreciation ▶ ______ (attach schedule)				
56 Investments—other (attach schedule)				
57 Land, buildings and equipment: basis ▶ ______ minus accumulated depreciation ▶ ______ (attach schedule)				
58 Other assets ▶ ______				
59 Total assets (add lines 45 through 58)				
Liabilities				
60 Accounts payable and accrued expenses				
61 Grants payable				
62 Support and revenue designated for future periods (attach schedule)				
63 Loans from officers, directors, trustees, and key employees (attach schedule)				
64 Mortgages and other notes payable (attach schedule)				
65 Other liabilities ▶ ______				
66 Total liabilities (add lines 60 through 65)				
Fund Balances or Net Worth				
Organizations that use fund accounting, check here ▶ ☐ and complete lines 67 through 70 and lines 74 and 75.				
67a Current unrestricted fund				
b Current restricted fund				
68 Land, buildings and equipment fund				
69 Endowment fund				
70 Other funds (Describe ▶ ______)				
Organizations that do not use fund accounting, check here ▶ ☐ and complete lines 71 through 75.				
71 Capital stock or trust principal				
72 Paid-in or capital surplus				
73 Retained earnings or accumulated income				
74 Total fund balances or net worth (see instructions)				
75 Total liabilities and fund balances/net worth (see instructions)				

Form 990 (1986) Page 4

Part VI **List of Officers, Directors, and Trustees (List each officer, director, and trustee whether compensated or not.) (See instructions.)**

(A) Name and address	(B) Title and average hours per week devoted to position	(C) Compensation (if any)	(D) Contributions to employee benefit plans	(E) Expense account and other allowances

Part VII **Other Information**

Yes No

76 Has the organization engaged in any activities not previously reported to the Internal Revenue Service? If "Yes," attach a detailed description of the activities.

77 Have any changes been made in the organizing or governing documents, but not reported to IRS? If "Yes," attach a conformed copy of the changes.

78 a Did the organization have unrelated business gross income of $1,000 or more during the year covered by this return?

b If "Yes," have you filed a tax return on Form 990-T, Exempt Organization Business Income Tax Return, for this year?

c If the organization has gross sales or receipts from business activities not reported on Form 990-T, attach a statement explaining your reason for not reporting them on Form 990-T.

79 Was there a liquidation, dissolution, termination, or substantial contraction during the year? (See instructions.) If "Yes," attach a statement as described in the instructions.

80 Is the organization related (other than by association with a statewide or nationwide organization) through common membership, governing bodies, trustees, officers, etc., to any other exempt or nonexempt organization? (See instructions.) If "Yes," enter the name of the organization ▶ .... and check whether it is ☐ exempt **OR** ☐ nonexempt.

81 a Enter amount of political expenditures, direct or indirect, as described in the instructions

b Did you file Form 1120-POL, U.S. Income Tax Return for Certain Political Organizations, for this year?

82 Did your organization receive donated services or the use of materials, equipment, or facilities at no charge or at substantially less than fair rental value?

If "Yes," you may indicate the value of these items here. Do not include this amount as support in Part I or as an expense in Part II. See instructions for reporting in Part III . . . . . . ▶

83 *Section 501(c)(5) or (6) organizations.*—Did the organization spend any amounts in attempts to influence public opinion about legislative matters or referendums? (See instructions and Regulations section 1.162-20(c).) If "Yes," enter the total amount spent for this purpose

84 *Section 501(c)(7) organizations.*—Enter amount of:

a Initiation fees and capital contributions included on line 12

b Gross receipts, included in line 12, for public use of club facilities (see instructions)

c Does the club's governing instrument or any written policy statement provide for discrimination against any person because of race, color, or religion? (See instructions.)

85 *Section 501(c)(12) organizations.*—Enter amount of:

a Gross income received from members or shareholders

b Gross income received from other sources (do not net amounts due or paid to other sources against amounts due or received from them)

86 *Public interest law firms.*—Attach information described in the instructions.

87 List the states with which a copy of this return is filed ▶ ....

88 During this tax year did you maintain any part of your accounting/tax records on a computerized system?

89 The books are in care of ▶ .... Telephone no. ▶ ....
Located at ▶

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than officer) is based on all information of which preparer has any knowledge.

▶ Signature of officer — Date ▶ Title

Paid Preparer's Use Only

Preparer's signature ▶	Date	Check if self-employed ▶ ☐
Firm's name (or yours, if self-employed) and address ▶	ZIP code	

SCHEDULE A
(Form 990)
Department of the Treasury
Internal Revenue Service

Organization Exempt Under 501(c)(3)

(Except Private Foundation), 501(e), 501(f), 501(k), or Section 4947(a)(1) Trust
Supplementary Information
▶ Attach to Form 990.

OMB No. 1545-0047

1986

Name

Employer identification number

Part I Compensation of Five Highest Paid Employees Other Than Officers, Directors, and Trustees (See specific instructions)

Name and address of employees paid more than $30,000	Title and average hours per week devoted to position	Compensation	Contributions to employee benefit plans	Expense account and other allowances
Total number of other employees paid over $30,000 ▶				

Part II Compensation of Five Highest Paid Persons for Professional Services (See specific instructions)

Name and address of persons paid more than $30,000	Type of service	Compensation
Total number of others receiving over $30,000 for professional services ▶		

Part III Statements About Activities

Yes (1) | No (2)

1 During the year, have you attempted to influence national, state, or local legislation, including any attempt to influence public opinion on a legislative matter or referendum? 1

If "Yes," enter the total expenses paid or incurred in connection with the legislative activities $ ____________

Complete Part VI of this form for organizations that made an election under section 501(h) on Form 5768 or other statement. For other organizations checking "Yes," attach a statement giving a detailed description of the legislative activities and a classified schedule of the expenses paid or incurred.

2 During the year, have you, either directly or indirectly, engaged in any of the following acts with a trustee, director, principal officer or creator of your organization, or any organization or corporation with which such person is affiliated as an officer, director, trustee, majority owner, or principal beneficiary:

a Sale, exchange, or leasing of property? 2a

b Lending of money or other extension of credit? 2b

c Furnishing of goods, services, or facilities? 2c

d Payment of compensation (or payment or reimbursement of expenses if more than $1,000)? 2d

e Transfer of any part of your income or assets? 2e

If the answer to any question is "Yes," attach a detailed statement explaining the transactions.

3 Do you make grants for scholarships, fellowships, student loans, etc.? 3

4 Attach a statement explaining how you determine that individuals or organizations receiving disbursements from you in furtherance of your charitable programs qualify to receive payments. (See specific instructions)

For Paperwork Reduction Act Notice, see page 1 of the separate instructions to this form.

Schedule A (Form 990) 1986

Schedule A (Form 990) 1986 Page 2

Part IV Reason for Non-Private Foundation Status (See instructions for definitions)

The organization is not a private foundation because it is (check applicable box; please check only **ONE** box):

5 ☐ ^{1} A church, convention of churches, or association of churches. Section 170(b)(1)(A)(i).
6 ☐ ^{2} A school. Section 170(b)(1)(A)(ii). (Also complete Part V, page 3.)
7 ☐ ^{3} A hospital or a cooperative hospital service organization. Section 170(b)(1)(A)(iii).
8 ☐ ^{4} A Federal, state or local government or governmental unit. Section 170(b)(1)(A)(v).
9 ☐ ^{5} A medical research organization operated in conjunction with a hospital. Section 170(b)(1)(A)(iii). **Enter name, city, and state of hospital ▶** ....
10 ☐ ^{6} An organization operated for the benefit of a college or university owned or operated by a governmental unit. Section 170(b)(1)(A)(iv). (Also complete Support Schedule.)
11 ☐ ^{7} An organization that normally receives a substantial part of its support from a governmental unit or from the general public. Section 170(b)(1)(A)(vi). (Also complete Support Schedule.)
12 ☐ ^{8} An organization that normally receives: (a) no more than 1/3 of its support from gross investment income and unrelated business taxable income (less section 511 tax) from businesses acquired by the organization after June 30, 1975, and (b) more than 1/3 of its support from contributions, membership fees, and gross receipts from activities related to its charitable, etc., functions—subject to certain exceptions. See section 509(a)(2). (Also complete Support Schedule.)
13 ☐ ^{9} An organization that is not controlled by any disqualified persons (other than foundation managers) and supports organizations described in (1) boxes 5 through 12 above or (2) section 501(c)(4), (5), or (6) if they meet the test of section 509(a)(2). See section 509(a)(3).

Provide the following information about the supported organizations. (See instructions for Part IV, box 13.)

(a) Name of supported organizations	**(b)** Box number from above

14 ☐ ^{0} An organization organized and operated to test for public safety. Section 509(a)(4). (See specific instructions)

Support Schedule (Complete only if you checked box 10, 11, or 12 above) Use cash method of accounting.

Calendar year (or fiscal year beginning in) ▶	(a) 1985	(b) 1984	(c) 1983	(d) 1982	(e) Total
15 Gifts, grants, and contributions received. (Do not include unusual grants. See line 28.)					
16 Membership fees received					
17 Gross receipts from admissions, merchandise sold or services performed, or furnishing of facilities in any activity that is not a business unrelated to the organization's charitable, etc., purpose					
18 Gross income from interest, dividends, amounts received from payments on securities loans (section 512(a)(5)), rents, royalties, and unrelated business taxable income (less section 511 taxes) from businesses acquired by the organization after June 30, 1975					
19 Net income from unrelated business activities not included in line 18					
20 Tax revenues levied for your benefit and either paid to you or expended on your behalf					
21 The value of services or facilities furnished to you by a governmental unit without charge. Do not include the value of services or facilities generally furnished to the public without charge					
22 Other income. Attach schedule. Do not include gain (or loss) from sale of capital assets					
23 Total of lines 15 through 22					
24 Line 23 minus line 17					
25 Enter 1% of line 23					▨

26 Organizations described in box 10 or 11:
a Enter 2% of amount in column (e), line 24 ....
b Attach a list (not open to public inspection) showing the name of and amount contributed by each person (other than a governmental unit or publicly supported organization) whose total gifts for 1982 through 1985 exceeded the amount shown in 26a. Enter the sum of all excess amounts here ....

(Continued on page 3)

Part IV Support Schedule (continued)(Complete only if you checked box 10, 11, or 12 on page 2)

27 Organizations described in box 12, page 2:

a Attach a list for amounts shown on lines 15, 16, and 17, showing the name of, and total amounts received in each year from, each "disqualified person," and enter the sum of such amounts for each year:

(1985)................ (1984)................ (1983)................ (1982)................

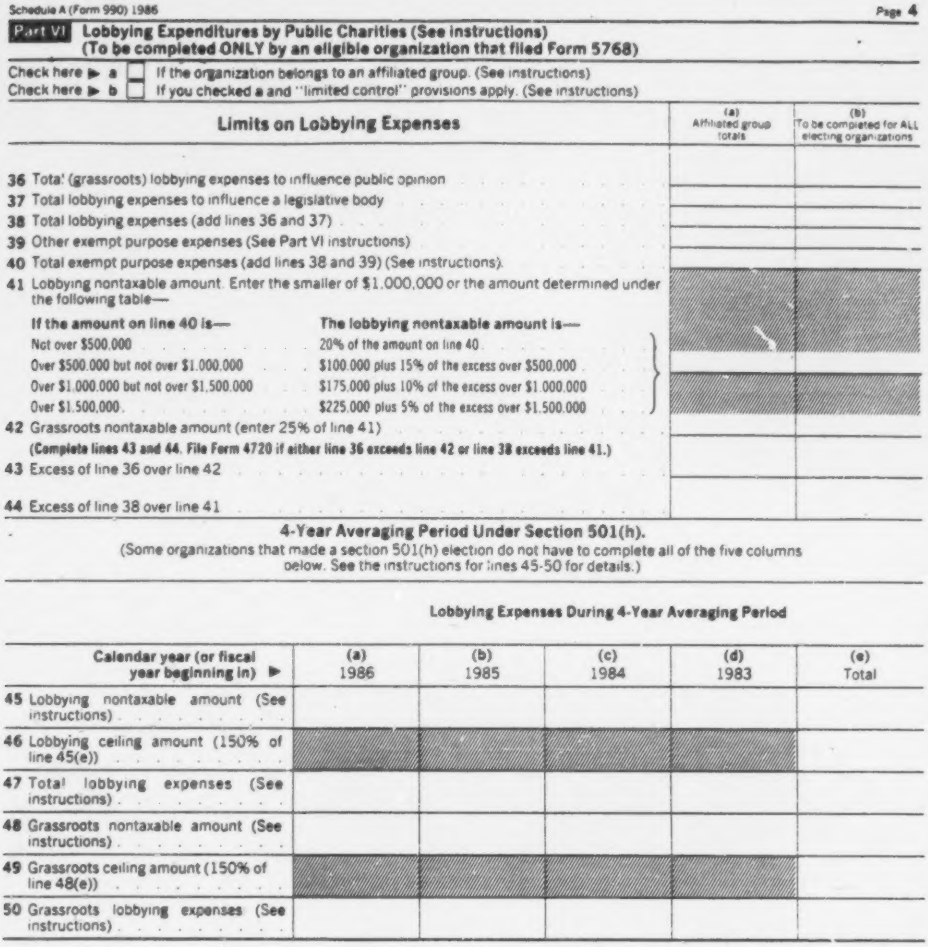
b Attach a list showing, for 1982 through 1985, the name and amount included in line 17 for each person (other than "disqualified persons") from whom the organization received more, during that year, than the larger of: the amount on line 25 for the year or $5,000. Include organizations described in boxes 5 through 11 as well as individuals. Enter the sum of these excess amounts for each year:

(1985) (1984) (1983) (1982)

28 For an organization described in box 10, 11, or 12, page 2, that received any unusual grants during 1982 through 1985, attach a list (not open to public inspection) for each year showing the name of the contributor, the date and amount of the grant and a brief description of the nature of the grant. Do not include these grants in line 15 above. (See specific instructions)

Part V Private School Questionnaire
To Be Completed ONLY by Schools That Checked Box 6 in Part IV

		Yes (1)	No (2)
29 Do you have a racially nondiscriminatory policy toward students by statement in your charter, bylaws, other governing instrument, or in a resolution of your governing body?	29		
30 Do you include a statement of your racially nondiscriminatory policy toward students in all your brochures, catalogues, and other written communications with the public dealing with student admissions, programs, and scholarships?	30		
31 Have you publicized your racially nondiscriminatory policy by newspaper or broadcast media during the period of solicitation for students or during the registration period if you have no solicitation program, in a way that makes the policy known to all parts of the general community you serve?	31		
If "Yes," please describe; if "No," please explain. (If you need more space, attach a separate statement.)			
32 Do you maintain the following:			
a Records indicating the racial composition of the student body, faculty, and administrative staff?	32a		
b Records documenting that scholarships and other financial assistance are awarded on a racially nondiscriminatory basis?	32b		
c Copies of all catalogues, brochures, announcements, and other written communications to the public dealing with student admissions, programs, and scholarships?	32c		
d Copies of all material used by you or on your behalf to solicit contributions?	32d		
If you answered "No" to any of the above, please explain. (If you need more space, attach a separate statement.)			
33 Do you discriminate by race in any way with respect to:			
a Students' rights or privileges?	33a		
b Admissions policies?	33b		
c Employment of faculty or administrative staff?	33c		
d Scholarships or other financial assistance? (See instructions)	33d		
e Educational policies?	33e		
f Use of facilities?	33f		
g Athletic programs?	33g		
h Other extracurricular activities?	33h		
If you answered "Yes" to any of the above, please explain. (If you need more space, attach a separate statement.)			
34a Do you receive any financial aid or assistance from a governmental agency?	34a		
b Has your right to such aid ever been revoked or suspended?	34b		
If you answered "Yes" to either 34a or b, please explain using an attached separate statement.			
35 Do you certify that you have complied with the applicable requirements of sections 4.01 through 4.05 of Rev. Proc. 75-50, 1975-2 C.B. 587, covering racial nondiscrimination? If "No," attach an explanation. (See instructions for Part V)	35		



Schedule A (Form 990) 1986 Page **4**

Part VI **Lobbying Expenditures by Public Charities (See instructions)**
(To be completed ONLY by an eligible organization that filed Form 5768)

Check here ▶ a ☐ If the organization belongs to an affiliated group. (See instructions)
Check here ▶ b ☐ If you checked a and "limited control" provisions apply. (See instructions)

Limits on Lobbying Expenses	(a) Affiliated group totals	(b) To be completed for ALL electing organizations
36 Total (grassroots) lobbying expenses to influence public opinion		
37 Total lobbying expenses to influence a legislative body		
38 Total lobbying expenses (add lines 36 and 37)		
39 Other exempt purpose expenses (See Part VI instructions)		
40 Total exempt purpose expenses (add lines 38 and 39) (See instructions).		
41 Lobbying nontaxable amount. Enter the smaller of $1,000,000 or the amount determined under the following table—	▨	▨
42 Grassroots nontaxable amount (enter 25% of line 41)		
43 Excess of line 36 over line 42		
44 Excess of line 38 over line 41		

If the amount on line 40 is—	**The lobbying nontaxable amount is—**
Not over $500,000	20% of the amount on line 40
Over $500,000 but not over $1,000,000	$100,000 plus 15% of the excess over $500,000
Over $1,000,000 but not over $1,500,000	$175,000 plus 10% of the excess over $1,000,000
Over $1,500,000	$225,000 plus 5% of the excess over $1,500,000

(Complete lines 43 and 44. File Form 4720 if either line 36 exceeds line 42 or line 38 exceeds line 41.)

4-Year Averaging Period Under Section 501(h).
(Some organizations that made a section 501(h) election do not have to complete all of the five columns below. See the instructions for lines 45-50 for details.)

Lobbying Expenses During 4-Year Averaging Period

Calendar year (or fiscal year beginning in) ▶	**(a)** 1986	**(b)** 1985	**(c)** 1984	**(d)** 1983	**(e)** Total
45 Lobbying nontaxable amount (See instructions)					
46 Lobbying ceiling amount (150% of line 45(e))	▨	▨	▨	▨	
47 Total lobbying expenses (See instructions)					
48 Grassroots nontaxable amount (See instructions)					
49 Grassroots ceiling amount (150% of line 48(e))	▨	▨	▨	▨	
50 Grassroots lobbying expenses (See instructions)					

Chairman **Pickle**. We are glad to have your statement and the witnesses with you who are also at the table.

Professor, I have enjoyed your overview and I think it is very helpful to this committee, we are glad to have it. It gets us thinking about it and we kind of see the overall problem. I noticed that you give a lot of history and you raise a lot of questions but you don't give any specific answers or recommendations. Are you in a position to do that? I know on your last page you list several questions that you raise in a provocative manner. Do you make any specific recommendation on what we can do?

For instance, you say we need further clarification of the law. Specifically, in what way should we have clarification?

Mr. **Hopkins**. First of all, Mr. Chairman, I was asked to come to provide the historical perspective and the summary of the law, and, without making it sound like I am ducking your inquiry, I was not asked to provide any specific recommendations. Being in full-time private practice in this area, it would be a little difficult for me, just without some opportunity to think it through, to provide specific recommendations.

I am a little bit concerned about it from this standpoint because, while there have been instances of abuse, I am troubled by the thought that these abuses may lead to the thinking that this is a widespread problem. I think the GAO analysis shows that it is not a widespread problem and, therefore, I would have to offer my concern to the subcommittee about authoring legislation that was so extensive that it hurt far more entities than it cured.

As far as specific recommendations, I think a few policy considerations have to be thought through first. For example, is it really inappropriate for a public charity to engage in certain types of lobbying in direct furtherance of its charitable purposes? Congress has never really specifically addressed that question. The courts have said it is inappropriate, although the Supreme Court seems to feel somewhat to the contrary. So I think that is still an open issue.

If it is inappropriate, then the question is, should it be done by the organization itself or should the law cause the lobbying or political campaign activity to be in a separate entity?

Chairman **Pickle**. Well, Mr. Hopkins, I recognize that you were asked to give an overview and not specific recommendations, but the committee would like to visit with you later and have suggestions from you, and any others who will be testifying, because we are looking for some answers.

I take it that in some instances, you question the practice of in tandem organizations that are controlled by one person or group, apparently, in connection with several others. Do you think that is a serious question and something that Congress should specifically address? Is that one area we could concentrate on?

Mr. **Hopkins**. Yes, Mr. Chairman. I am not concerned about it. First of all, it is a permissible practice under existing law. There is no specific statutory law on the point to speak of, but as a matter of practice and through the IRS ruling policy and the case law, it is clear that a 501(c)(3), for example, can have a 501(c)(4) lobbying arm; just as a business league can have a PAC or a business league can have a charity foundation.

Chairman **Pickle**. Well let me ask you, I guess I might as well be specific in this area. While they have in tandem organizations, we also know about the growth of political foundations, both 501(c)(3), (4) and PAC's, all operating out of the same organization, the same address, the same place. Because this question is going to come out at some point, let me just ask you your personal opinion of some ads that ran this last fall. I'm going to read them to you. I understand you have a copy of these ads that have been run by the National Endowment for the Preservation of Liberty.

Mr. **Hopkins**. Yes, Mr. Chairman, I do.

Chairman **Pickle**. One ad says, and I guess the best way to do it is to just lay it out here. One ad says, "Hey, you see what some Democrats in Washington are saying now? They say give economic aid to the Communists in Nicaragua and all our problems will go away."

"What about Qadhafi? He needs some new boats. And Castro? His military's getting rusty."

"And to show we are nice guys, a few mil for our generous host in Iran, the Ayatollah Khomeini."

"Hey, when are those Democrats going to learn? The Communists in Nicaragua—they don't want our money. They want us." And that was run and paid for by a 501(c)(3) organization.

Another ad that ran by the same organization says, "The Communists now have 120,000 men under arms in Nicaragua. And Congressman J.J. Pickle still isn't supporting the President on Nicaragua. Better wake him up."

"The Communists are now completing this huge submarine base in Nicaragua. And Congressman Bill Hefner still isn't supporting the President. Better wake him up."

"Communists planes can strike us in only 2 hours from this new base in Nicaragua. And still Congressman Ed Jones won't support the President. Call him."

Now, that one was run by a 501(c)(4).

And the third one was, "This is a message in search of two votes. Two more Congressmen who will vote no to communism in Nicaragua."

"We know what happened when the last vote failed. While Sandinistas danced in the streets, Commandante Ortega celebrated in Moscow. And Russia promised $200 million more in military and other aid to their Russian friends. They had a ball, all right. This time let's tell them the party is over."

Now, that one was a PAC, all run essentially by the same organization. Now, I ask you, is that political lobbying, or is that educational lobbying? How would you term the ad? You've had a chance to see them. This is just your individual viewpoint. And I want to make it plain that in mentioning these ads I do so because they are timely, they just occurred, and not because the White House is now controlled by the President. The same type of propaganda or the same type of lobbying could be just in reverse if the Democrats were down.

And the question is, Is this permissible? Is this political or lobbying, is it proper? How would you label it?

Mr. **Hopkins**. Mr. Chairman, let me answer your general question first. The law is quite clear that, as long as an organization is a bona fide entity, it can be operated in tandem with another one. In other words, the fact that it is at the same location or has somewhat the same board, same officers, same staff, uses the same facilities and so forth is not the test. The question is whether it is a bona fide entity with a legitimate separate purpose.

So under existing law, you can have a (c)(6) and a (c)(3) and a PAC and so forth in the same physical location, as long as they are bona fide entities.

Chairman PICKLE. We understand that.

Mr. HOPKINS. And the IRS asks that the allocations of expenses between these entities be done on a reasonable basis.

Of course, in the proposed regulations under the elective rules, there are very specific provisions in there for allocations of expenses.

As far as the specific questions you have, let me take the easiest ones first. The last page—and I have not seen these telecasts; I'm just looking at the text—would be a legitimate activity, in my judgment, for a political action committee. The middle page, the telecast that I understand was done by a 501(c)(4) organization, that is lobbying. And of course, there is no restriction on lobbying by 501(c)(4) organizations, so that particular telecast would not be an inappropriate undertaking for a 501(c)(4).

Chairman PICKLE. It would be lobbying, but not illegal.

Mr. HOPKINS. It is lobbying but it is not improper. It is not contrary to the Federal statutes.

The first page, which I understand is a telecast paid for by a 501(c)(3) organization, this is a little more difficult to analyze. I would point out to the subcommittee that no specific legislation is referenced in the statement. It does touch on subjects that could give rise and have given rise to legislation, but there is no specific appeal in there for a particular legislative action. And it certainly is not asking the viewers to take action.

So I think under existing law, it is vague.

The statute, I would point out, not only talks about legislative activities but talks about propaganda. That is a rather antiquated term and the court system has essentially thrown out the Internal Revenue Service regulations on this subject. So we don't have much law on this point.

The old law used to be that a 501(c)(3) organization had to give a full and fair exposition of the pertinent facts. Obviously, that was not done in this 30-second spot. So there is an open question in my mind as to whether it is legislative activity and, under the current state of the court law, I think it's an open question as to whether it is propaganda.

Mr. ANTHONY. Mr. Chairman, would you yield just for a quick interpretation of the answer?

Chairman PICKLE. I yield to Mr. Anthony.

Mr. ANTHONY. Mr. Hopkins, you say that they are not asking for anything. First paragraph, "This is a message in search of two votes." Congressmen are mentioned. That's obviously two votes in the House of Representatives. So that is a specific request.

Mr. HOPKINS. Well, that's true, Mr. Anthony, but that is the telecast that was done by the PAC.

Mr. ANTHONY. That is the last one.

Mr. Hopkins. That is the one that was done by the PAC and my comment on that was addressed to the 501(c)(3).

Mr. Anthony. Okay, fine, thank you.

Mr. Flippo. Mr. Chairman.

Chairman Pickle. I will recognize each member in just a second. My question to you is, does it have any importance as to the timing of these ads, when they are run? These were run in connection with elections, the general election, or it could have been in front of the primary, and in connection with a specific vote in an attempt to obviously influence or "pressure" a candidate to vote in a certain manner.

Does the timing of it have any importance to you?

Mr. Hopkins. Yes, Mr. Chairman, it does. Under the existing law, the timing of a message like this is extremely important. The Internal Revenue Service, in an analogous context, has ruled many times that what may be an educational statement in one timeframe may be a political or legislative statement in another, depending on the context with an election.

Chairman Pickle. Mr. Hopkins, I know that the members all have questions or may want to get questions and I am not going to prolong this. I hope that we will have a chance to visit with you later. I know that you have given us a good historical review of the law. We are trying to find out now what we do. Now, if Congress needs to express itself separate and apart from the common law, then that is our challenge. And how we approach that is going to be a difficult task, and I hope we can have your further cooperation on it.

Let me ask the GAO before I finish, you say here that limited data is available. That is, you could not get the information. Is it the IRS? Or where did you go to look for this information? Internal Revenue Service primarily?

Ms. Stathis. Internal Revenue Service, that's correct.

Chairman Pickle. And you say the data is limited. Does that mean that they just don't keep records? Is there no audit division down there?

Ms. Stathis. The type of information that tax-exempts are asked to provide in the application form relates to what they plan to do. A tax-exempt that planned 20 years ago when it applied for tax-exempt status to do one thing may be doing something differently today. The information that is provided on that form is what IRS has on its master file.

Chairman Pickle. As I understood your statement, you said that the form 990 was not very useful. I assume from that you mean that it was so broad that it didn't specify specific information that would be helpful in this particular area. Or at least you implied that it wasn't very useful.

Do you or any of your staff want to comment on that?

Ms. Stathis. If you want to get an overall picture of the amount of lobbying and political activity, the form 990 is limited in its ability to give you that information. For example, a (c)(4) organization, which is allowed to lobby, is not required to answer any lobbying questions on the form 990. Therefore, you could not get a picture of the amount of lobbying by this group.

Ms. Fauntleroy has something to add.

Ms. FAUNTLEROY. The 990 is limited for several reasons in defining the extent and type of lobbying and political activity that organizations may be engaged in.

From the first standpoint, all exempt organizations are not required to file a 990. The second point, in dealing with lobbying information that is reported on the 990, primarily just the (c)(3)'s, (5)'s and (6)'s have to report specific information about their lobbying activities. The other exempt organizations are not required to specifically identify lobbying activities and expenditures associated with those activities.

As far as political activities are concerned, all tax-exempt organizations that file the 990 are required to report political expenditures, but the 990 does not require a lot of detail on the type of political activities for which they are reporting expenditures.

The fourth way that the information is limited is the tax-exempt organization does not indicate on the 990 whether or not its affiliated organizations may have engaged in lobbying or political activities.

Chairman PICKLE. Say that again. The 990 does not what?

Ms. FAUNTLEROY. The form does not require the tax-exempt organization to indicate whether or not its affiliated organizations engaged in lobbying or political activities.

Chairman PICKLE. Well, I thank you very much. Let me ask the members if you could stay within your time prescribed limitations.

Mr. SCHULZE. Yes, Mr. Chairman, I assure you I will not take anymore time than you have with questions. [Laughter.]

Mr. Hopkins, in the discussion you had with the chairman on those particular ads, were you given the entire bundle of ads or just the three?

Mr. HOPKINS. Just the three, sir. And I've not seen the telecast.

Mr. SCHULZE. I don't really want to get into who struck John here, but I have a whole series of ads. There are about 12 or 13 ads by the National Endowment for the Preservation of Liberty. As I glanced through them, I saw only one that specifically named Democrats. I have to agree with you that that would be one that would be subject to interpretation. The rest of them would probably more properly be classified as educational, so that I think we should have a proper perspective on the entire package.

The point is should we build fences or walls between these various organizations so that we don't get this type of interlocking action or interaction? I guess from your earlier answer that you don't really want to go into that now. Is that correct? That you want to think about that and perhaps we can discuss it informally later?

Mr. HOPKINS. No, I would be happy to talk about it a little bit. I was just uncomfortable expressing an opinion with respect to a particular organization when I had just seen a few examples of what they were doing.

Mr. SCHULZE. Sure. Let's talk about it in generalities because quite frankly, there was an organization—I forget the name—which was lobbying against some of the nominees for the courts. It was an organization coming from the left doing the same exact kind of thing that this is. I would rather not get into that. Let's talk about the overall policy.

Do you think that if we prohibited directors and perhaps even personnel in a section 501(c)(3) organization from being affiliated or involved with the other types of charitable organizations, that might fence it off and prevent abuse?

Mr. HOPKINS. There is no question that that approach, as you put it, would "fence it off." I frankly would not want to endorse that approach. I happen to think the utilization of separate organizations is more a favorable approach in this area, rather than a problem.

I don't think the use of separate entities, per se, is a problem and, in fact, it could be the solution. If there's an abuse, it's the interfunding of the two, where the operation of the two is in such a way that they're really one. If they are bona fide organizations, separate bank accounts, and there's no commingling of funds, it seems to me that is more of a solution than a problem.

Mr. MCGRATH. Would the gentleman yield?

Mr. SCHULZE. Yes.

Mr. MCGRATH. Thank you for yielding, Mr. Schulze.

I would like to get off of the political end of it and get more into lobbying for one second, specifically on that answer that you gave. Obviously 501(c)(3)'s cannot get into political activity, but lobbying activity is somewhat of a gray area, as you have stated.

However, in this report, put together by the Joint Committee on Taxation, prepared for this hearing, it says as a definition of lobbying, "Moreover, lobbying may not include soliciting government funds for organizations' programs."

Now I would venture to guess that each of us on this panel, and anybody in the Congress, could tell you that whether it be universities or hospitals or other 501(c)(3) not-for-profit organizations, we are continually deluged for more money for specific grants or programs or whatever.

In your judgment, are these illegal activities of these 501(c)(3) organizations? Should they come in and lobby us for more money for their specific programs?

Mr. HOPKINS. No, they are by no means illegal. The concept of lobbying is a petition to the legislative branch for changes or lack of changes in the statutes. Appeals to the executive branch or testimony on appropriations, in my judgment, is not what is conventionally termed "lobbying."

Mr. MCGRATH. Well, the budget bill would be a——

Mr. HOPKINS. That is a statute, obviously, yes, sir.

Mr. MCGRATH. Yes. Now let's say we are still in this gray area. If those 501(c)(3) organizations got together and pooled a certain amount of their money and hired somebody to go ahead and do that activity for them, is that a gray area, too? Or is that prohibited?

Mr. HOPKINS. No, it's not prohibited, and it's not a gray area, either. The expenditures in that regard would be traced, and would be deemed to be, if they are legislative activities at all, would be deemed to be legislative expenditures by each organization.

Mr. MCGRATH. What you are saying in effect, then, is that even though the statute prohibits lobbying, there are enough ways of getting around it that in effect these 501(c)(3) organizations can lobby?

Mr. HOPKINS. Well, the statute prohibits lobbying to a substantial extent. So by definition, then, a 501(c)(3) organization can lobby to an extent that's less than what is substantial.

Mr. McGRATH. That's only described in case law or——

Mr. HOPKINS. No, no, that's in the statute, the substantiality test is in the statute.

Mr. McGRATH. Well, that's only a money——

Mr. HOPKINS. Well, it's not clear from the statute if it's meant to be money or time. It says no substantial part of the activities. The elective rules that were enacted a decade ago indirectly define "substantiality" in terms of expenditures.

Mr. McGRATH. Let me ask you the final question. Is it your observation then that some of these gray areas and some of these substantiality questions need to be tied down, or do you think that we ought to just leave it alone?

Mr. HOPKINS. Well, my own personal view is that a 501(c)(3) ought to be able to lobby directly on matters of direct importance to its exempt status. I realize that's not the full state of the law. That's my own personal view.

The elective rules that were enacted in 1976 have been designed to do exactly what you propose, to put specific mechanical tests in place to measure how much lobbying expenditures can be done by a 501(c)(3) organization.

Mr. McGRATH. I thank the gentleman for yielding.

Mr. ANTHONY [presiding]. Mr. Jacobs.

Mr. JACOBS. Mr. Chairman, with the first 2 of 17 scheduled witnesses under the 5-minute rule, the committee has now consumed 1 hour and 10 minutes. I assume that we have about 7 hours to go. So as a charitable contribution to the remaining witnesses, I yield back the balance of my time. [Laughter.]

Mr. ANTHONY [presiding]. Your charitable contribution is received with open arms by the chairman.

Mr. Ford.

Mr. FORD. Mr. Chairman, I associate myself with his remarks. [Laughter.]

Mr. ANTHONY. We're on a roll. Mr. Dorgan.

Mr. DORGAN. I yield my time to Mr. Jacobs. [Laughter.]

Mr. JACOBS. I reserve it to the next hearing of the committee.

Mr. ANTHONY. Well, our thanks for your valuable contribution tc the record.

Mr. FORD. Mr. Chairman, I do have an opening statement that I would like to have unanimous consent to have placed in the record.

Mr. ANTHONY. Is there objection? Without objection, the statement from Mr. Ford will be submitted for the record.

[The statement follows:]

OPENING STATEMENT OF CONGRESSMAN HAROLD FORD

These hearings provide a unique opportunity for the Members of this Committee to gain a renewed understanding of and appreciation for the important role played by voluntary associations in serving public officials, and the public generally, by providing invaluable information and public input. In 1976, which was the last time that a body of Congress closely examined the issue of lobbying by tax-exempt organizations, Congress affirmed the importance of maintaining, indeed expanding, the opportunities for communications between exempt organizations and public officials. The so-called Conable option, passed as part of the Tax Reform Act of 1976, liberalized the rules governing lobbying by public charities and provided them with a clear set of definitions and percentage limitations so that they could be assured of the ability to lobby to the fullest extent permissible by law without fear of losing their exempt organizations, their member, the general public, and government.

It is of the utmost important that we maintain the distinction between lobbying by public charities and what has been called electoral or political activity of tax exempt organizations. The latter is clearly prohibited under the law and if such activity is being conducted by exempt organizations, we must put a stop to it. Lobbying, on the other hand, is permissible; in fact, encouraged by Congress. Although limited, we must not underestimate how important the freedom of exempt organizations to speak out on issues and causes is to our civil liberties and openness as a society. These institutions are invaluable as a complement to government, as a voice box for people working for a better society, and sometimes even as a conscience for elected officials.

The benefits of free and open communication between exempt entities and public official are many, and I'm sure this panel will provide us with a number of examples of improved public policies brought about as the result of the committed work of voluntary associations.

Mr. ANTHONY. Thank you, Mr. Hopkins.

Our next panel will be the Honorable Roger Mentz, Assistant Secretary for Tax Policy, Department of Treasury, and the Honorable Lawrence B. Gibbs, Jr., Commissioner, Internal Revenue Service. We welcome our two guests.

Gentlemen, if you are ready, we will take your testimony. Mr. Mentz, welcome.

STATEMENT OF HON. J. ROGER MENTZ, ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY

Mr. MENTZ. I am pleased to have an opportunity to review with the subcommittee the Federal tax rules applicable to lobbying and political activities of tax-exempt organizations.

I have a fairly extensive statement which lays out the current law on this subject. If you would have no objection, I would like to file that for the record, skip over it, with two exceptions, and get right into our recommendations for change in the law.

Mr. ANTHONY. Without objection, your complete statement will be submitted for the record and you are permitted to summarize.

Mr. MENTZ. Thank you very much, Mr. Chairman. I will now turn to what is page 4 of the written testimony dealing with prohibition against becoming a social welfare organization. I would just like to cover this because it is important to the recommendations.

Under the current law an organization that cannot qualify for exemption under 501(c)(3) because it engages in substantial lobbying activities may qualify as a social welfare organization under 501(c)(4). In that case contributions to the organization are not deductible but it is nevertheless tax exempt.

In, I believe it was, 1976 Congress passed section 504 of the code which prohibits an organization which has lost its 501(c)(3) status because of excessive lobbying from qualifying for tax exemption as a 501(c)(4) organization. In other words, you can't flip from a 501(c)(3) organization that is disqualified into a 501(c)(4) organization. You have to stay disqualified until the organization requalifies.

I think that was an important step taken by Congress and I think we will see that perhaps some more steps in that direction may be appropriate.

Let's move to affiliated organizations which were mentioned at the outset. Congressman Schulze mentioned them and there is no question that there are some real issues involving affiliated organizations.

A 501(c)(3) organization that desires to engage in substantial lobbying may establish a separate 501(c)(4) organization and typically the 501(c)(3) organization, which is entitled to receive tax deductible contributions, carries on the research and educational activities while the 501(c)(4) organization carries on the lobbying activities.

That arrangement is permissible under present law so long as separate books are kept and expenses are properly allocated between the two organizations.

Under section 482 of the Internal Revenue Code, the Service has the authority to reallocate expenses between exempt organizations under common control in order to reflect accurately the substance of their dealings.

For example, if a 501(c)(3) organization conducts research and prepares an extensive report for the use of a lobbying effort carried on by a 501(c)(4) organization, at least part of the cost of the research and the report should be allocated to the 501(c)(4) organization.

If the organizations have not properly allocated expenses, the misallocation could have grave consequences. It could be viewed as a contribution by the 501(c)(3) organization to the 501(c)(4) organization in order to carry out its lobbying activities, thereby subjecting the 501(c)(3) organization to loss of its exempt status if the lobbying is substantial.

Alternatively, the misallocation of expenses could be viewed as a loan to the 501(c)(4) organization in which case repayment of the loan could be required by the IRS.

With that introduction, let's turn to page 7 of the testimony dealing with political activities of private foundations. I just want to make a point here that again is relevant to our recommendations.

Private foundations are just like other 501(c)(3) organizations—they are limited as to their political activities. But in 1969 when the law was greatly changed regarding private foundations, there was a two-tier excise tax imposed on private foundations that engage in political activities.

Since then, any amount paid or incurred by a private foundation to influence the outcome of any public election or to carry on directly or indirectly any voter registration drive, except a specially qualified one, is treated as a so-called taxable expenditure.

A taxable expenditure will give rise to an excise tax both on the foundation and on the managers and, if it is not cured, there will be a second level excise tax. That is a sanction short of complete revocation of the exemption.

The revocation of exemption is still a sanction available to the IRS, but what has happened in the private foundation area, is there is a sanction short of complete revocation which seems to have worked very well since 1969. As you will see, we will get into the question of whether that might be appropriate for all 501(c)(3)'s, not just for private foundations.

Mr. Chairman, I would like to now turn to page 8 of the testimony which reviews our discussion of the basic policy behind the current statutory scheme and contains some recommendations for change.

I think we all acknowledge that exempt organizations play a vitally important role in our society. The numerous religious, charitable and educational institutions in our country contribute to and enrich virtually every aspect of American life.

These organizations do far more than simply lessen the burden of government, one of the traditional policy rationales for tax exemption, for they provide an abundance of diverse services and new ideas that no government could provide.

Notwithstanding the importance of these institutions to our society, present law reflects a congressional judgment that in the matters of political campaigns and substantial lobbying activities, the subsidy of tax deductible contributions generally should be denied.

In the area of lobbying activities, as Mr. Hopkins indicated, the rationale for the current restrictions on substantial lobbying activities has never been clearly articulated. It certainly would be possible to come up with a system that would rationalize the rules for, for instance, veterans organizations and the rules under section 162(e) which allow a trade or business to deduct lobbying expenses, other than grassroots lobbying expenses, that are directly related to its business.

It would be possible to rationalize those and to change the charitable rules so that they are in a more parallel form.

However, these basic rules have received significant consideration by Congress over the past 20 years. The rules on private foundations were carefully considered in 1969. In 1983, this subcommittee reviewed the private foundation rules and did not recommend any changes in the area.

With regard to public charities, lobbying activities were the subject of extensive discussion in congressional hearings in the early 1970's.

There were suggestions that public charities should not be allowed to engage in grass roots lobbying at all but, rather, like businesses should be allowed to engage only in direct lobbying on matters directly related to their exempt purposes. Such a rule would create a more equitable balance between the tax treatment of exempt organizations and businesses engaged in lobbying.

Others suggested that some restrictions should be imposed on the type of direct lobbying in which public charities could engage.

In 1976, when Congress enacted the expenditure test and other provisions relating to lobbying by public charities, it struck a balance that permits 501(c)(3) organizations to engage in both grassroots lobbying and direct lobbying but continues to restrict the extent of their lobbying activities.

Although a conceptual argument may exist for more parallel treatment, Congress has not followed that approach in the past. Moreover, there would be a substantial revenue impact associated with a liberalization of the amount of direct lobbying permitted by 501(c)(3) organizations.

This is an interesting point. The point is that organizations currently exempt under 501(c)(4) could convert to 501(c)(3) status, thereby receiving tax deductible contributions. That would constitute, we believe, a serious revenue drain.

In light of that and other factors and recognizing that present law represents a compromise among competing views, we do not recommend changes in the restrictions on lobbying by exempt organizations.

Particularly in view of the major tax legislation that we have enacted over the past several years, we don't think it is advisable to get into a wholesale revision of the rules regarding tax exempt entities but we do have specific recommendations for you of a more modest nature.

With regard to political activities, we believe that although there is little legislative history regarding——

Chairman PICKLE. Secretary Mentz, let me ask you, if you are going to make some recommendations, where are you on your statement?

Mr. MENTZ. Well, I started on page 8 and we are on page 11.

Recommendation No. 1, Mr. Chairman, is don't make a wholesale change in the statutory fabric. Recommendation No. 2 on political activities is, really along the same lines, that we continue to support the complete prohibition against political activities by tax exempt organizations. But, there are some specific issues that warrant congressional action.

First, I would like to deal with affiliated exempt organizations. As has been described earlier and recognized by the chairman and Congressman Schulze, a group that intends to engage in both educational and lobbying activities may organize separate organizations, typically a 501(c)(3) organization and a 501(c)(4) organization.

That arrangement is clearly permissible under current law if separate books and records are kept and, indeed, I think we would perhaps be on weak ground if we tried to prohibit that kind of association. There is at least a question as to the constitutionality of that and, in particular, I direct you to the concurring opinion of Mr. Justice Blackmun in the case of taxation with representation.

So, rather than a prohibition against this kind of arrangement, we have some other recommendations for you.

As you recognize, affiliated organizations often share facilities, staff and equipment. Allocation of expenses is perhaps not an easy matter for taxpayers or the Government but it is nevertheless very important.

There is obviously a fundamental tension. A 501(c)(3) organization receives tax deductible contributions but its lobbying activities are limited to an insubstantial part of its total activities.

In contrast, a 501(c)(4) organization does not receive tax deductible contributions but is not so limited in its lobbying activities.

So there is an incentive, for example, for a 501(c)(4) organization that is planning a lobbying campaign to have an affiliated 501(c)(3) organization conduct research and prepare reports with a view to using such reports for lobbying.

The organization may allocate all of the research expenditures to the 501(c)(3) organization, and this would be an aggressive position but one that can occur in real life, and allocate only the cost of making direct contact with legislators or members of the public to the 501(c)(4) organization. That would be a case of misallocation but, nevertheless, a troublesome case for tax administration.

In order to enforce the requirement that affiliated organizations keep separate records and make reasonable allocations, the Internal Revenue Service must be able to conduct a coordinated audit of the affiliated organizations.

Under current law, this is difficult if not impossible. Despite the affiliation, the organizations in the example I just described file separate returns and in some circumstances may not disclose the extent to which the 501(c)(3) organization has assisted the 501(c)(4) organization.

Although form 990 contains a question as to whether the organization is affiliated with any other, the question has failed to elicit useful responses.

So, therefore, Mr. Chairman, we recommend that the subcommittee consider, one, a statutory definition of affiliated exempt organizations and, two, a statutory requirement that organizations that meet the statutory definition of affiliation disclose the names and taxpayer identification numbers of affiliated organizations, and furthermore, that penalties for failure to provide this information be enacted.

We note that there is a definition of affiliated organizations in section 4911. That certainly would provide a good starting point for such an approach.

I would similarly note that there are other more subtle issues involved in affiliated enterprises. For example, if you have a candidate running for political office, a 501(c)(3) organization could be engaged in an activity that purports to be purely educational but, nevertheless, through the particular educational information that it is putting out to the general public, could have a beneficial effect on that candidate's likelihood of success.

We have not devised a specific recommendation on that one. I think if you want to pursue it, it might be worth getting together with your staff and see if we can't come up with something, but we don't have anything specific on that. I simply mention it because it is a subtle form of perhaps misuse of the 501(c)(3) benefit.

With regard to sanctions, as was noted, if a 501(c)(3) organization doesn't elect to be subject to the special expenditure test under 501(h), it's subject to loss of tax exempt status if it engages in substantial lobbying activities. We have a fairly vague test here. The substantial part test really provides little guidance to taxpayers and it's difficult for the IRS to administer. This is particularly troublesome where the only available sanction is revocation of the tax exemption. This sometimes leaves the Service open to accusations of politically motivated enforcement in the case where it does seek to revoke the tax exemption of a 501(c)(3) organization.

We commend the Congress on enactment of section 501(h). Section 501(h) really is a significant improvement over the substantial part test. It provides something of a mechanical rule, but a more definitive rule for determining exemption, and also it provides a method of imposing an excise tax, a penalty short of complete elimination of tax exemption, for lobbying that goes beyond an exemption amount. We note that that is a more appropriate sanction, an excise tax for initial violation, and it provides a fair warning prior to revocation of exempt status to organizations that are engaged in impermissible levels of lobbying.

We would suggest to you that a similar approach may well be appropriate for political activities. As I mentioned earlier, we have an excise tax regime for private foundations that engage in political activities, and we believe that, while it is appropriate to have available the sanction of complete loss of exemption for engaging in political activities, a scheme such as the private foundation scheme that we have in the current law might be more appropriate. That would mean in lieu of automatic revocation, you might consider imposition of an excise tax on public charities that engage in political activities. That tax could be similar to the tax that is imposed on private foundations under section 4945.

Thus, if a tax is imposed both on the organization and on the management, if the management acted with knowledge that the expenditure was for political activities, that would be a sanction short of revocation of the exemption. The statute should require a correction of the prohibited expenditure as it does in the private foundation area, and in the case of repeated or flagrant violations, certainly the sanction of loss of exemption is still appropriate.

Earlier the problem of successor organizations was noted. I think you noted it, Mr. Chairman. A 501(c)(3) organization gets caught doing something it shouldn't, and it goes away and up pops another 501(c)(3) organization which starts doing the same thing, and applies for tax exemption. We agree with you that that is a problem that ought to be corrected, and ought to be corrected legislatively.

It's our recommendation that you consider legislation that would require organizations applying for recognition of exempt status to disclose the names and taxpayer identification numbers of any affiliated organization, either currently in existence or in existence during a preceding period of, say, 5 years, and have appropriate penalties for failure to provide such information. I think we need, the Service needs that kind of an——

Chairman PICKLE. Let me interrupt you to see if I understand you. You said you think that individuals who make contributions should be checked to see if they made similar contributions?

Mr. MENTZ. No, not the contributor, but the new organization that makes an application for determination of tax exemption. The members of that organization would have to notify the Internal Revenue Service of any affiliated predecessor organization with the name and the identification number that goes back 5 years.

Chairman PICKLE. Then I raise the question then, I'm not going to interrupt you any more, but I'll raise the question. What about making known the people who contribute a certain amount of funds to 501(c) (3), (4), (5), (6), (7), or whatever? I understand that information is not known now unless it's over a certain amount. Should we make changes in that area?

Mr. MENTZ. You mean have some public disclosure of contributors?

Chairman PICKLE. Yes. People give millions of dollars to a particular organization and we don't know who gave, who they are, or anything about it. Is that a good thing for us to know?

Mr. MENTZ. Well, I suppose there would be some——

Chairman PICKLE. There's no way for you to check them, is there? If you don't know who is giving, how do you know whether they are claiming a deduction or not?

Mr. **Mentz**. I don't know whether——

Chairman **Pickle**. I guess that's a question for Mr. Gibbs.

Mr. **Mentz**. Whether the Internal Revenue Service could check them. I do think that there may be some donors to legitimate charities who may wish to remain anonymous, and it would be for legitimate and not inappropriate reasons, so I would think that we would be better off handling it at the organization level, rather than the donor level.

Chairman **Pickle**. We'll ask Mr. Gibbs about this in particular. I'm sorry for interrupting, Mr. Mentz.

Mr. **Mentz**. That's quite all right.

Mr. **Dorgan**. Mr. Chairman, on that point on which you interrupted, might I just clear up a question that entered my mind on your statement, Mr. Mentz? You suggested that the Congress might request more information on the affiliated organizations here. It seems to me that there would be nothing that would bar the IRS from asking for all of the relevant information on any forms they would so prescribe to determine whether they want to grant tax-exempt status. While you recommend legislation, isn't it a fact that there's plenty of authority at present to request all of that relevant information?

Mr. **Mentz**. I'm not sure there are the sanctions for failing to report it, Mr. Dorgan. I think that's the problem. I think we'd feel more comfortable with an explicit statutory grant.

Mr. **Dorgan**. But the authority certainly exists to ask for all the relevant information when someone is now applying for tax exempt status, I would expect.

Mr. **Mentz**. Yes, there would be——

Mr. **Dorgan**. We need to strengthen the sanctions, I understand that, but I would expect the authority does now exist.

Mr. **Mentz**. There are also some definitional issues as to what is an affiliated organization. I suppose your answer to that is, well, you could develop them administratively, and I suppose that's a possibility. I think we'd feel more comfortable—this is a delicate area, particularly for the Service—and I think there might be a higher comfort level if we had the imprimatur of Congress authorizing it.

Just a couple more, please bear with me.

Regarding revocation of exempt status, although revocation of exempt status is sometimes a very harsh penalty, in other cases it's an ineffective sanction. That could be the case where a 501(c)(3) organization has already spent all its money and is really not in a position where tax exemption is important on an ongoing basis.

There could be remedies for that. You may wish to consider some form of a sanction on organizations that lose their exempt status because of political or substantial lobbying activities. That could be possibly a monetary penalty on the organization, or possibly a fine on the managers of the organization who knew of, or were responsible for, the impermissible conduct.

Getting back to an earlier recommendation, because of the vagueness of the substantial part test, a preliminary or warning sanction is quite appropriate here. That may be some form of an excise tax before you take them into a full revocation of tax exemption with further sanctions.

And so to summarize, Mr. Chairman, we generally agree with the overall framework of current law which prohibits more than an insubstantial amount of lobbying by charitable section 501(c)(3) organizations, and precludes or prohibits political activities by such organizations. We think you might want to consider the following changes to current law.

First, a statutory definition, and required disclosure of, affiliated exempt organizations on information returns with appropriate penalties for failure to provide them. Two, an excise tax on 501(c)(3) organizations that participate in political activities as a kind of early warning before revocation of the exemption. Three, required disclosure of current or past affiliated organizations on applications for recognition of exempt status.

You may also wish to consider whether sanctions in addition to revocation of exempt status might be appropriate for organizations that lose their exempt status because of political activity or substantial lobbying and where the exempt status revocation is not a significant sanction.

We would be pleased to work with the subcommittee and its staff to develop proposals in greater detail. Mr. Chairman, this concludes my prepared testimony. I would be pleased to respond to questions.

[The prepared statement follows:]

Release Upon Delivery
Expected at 9:00 A.M., E.S.T.
March 12, 1987

STATEMENT OF
THE HONORABLE J. ROGER MENTZ
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to review with the Subcommittee the Federal tax rules applicable to lobbying and political activities of tax exempt organizations.

I will give a brief summary of present law and will discuss the rationale for the current restrictions on lobbying and political activities by certain exempt organizations. I will offer several recommendations that you may wish to consider to improve the operation of the law in this area. The Honorable Lawrence B. Gibbs, Commissioner of Internal Revenue, will describe the Internal Revenue Service's examination program and its experience in administering present law. Although other laws also apply to lobbying and political activities by exempt organizations, such as the Federal Election Campaign Act, we will not be addressing those laws except by occasional reference.

BACKGROUND

Section 501(c) of the Internal Revenue Code of 1986 (the "Code") describes twenty-five types of organizations that are generally exempt from federal income tax (except to the extent of their unrelated business taxable income described in section 512). Contributions to some of these organizations are deductible for federal income, estate, and gift tax purposes. Tax exempt organizations are subject to a variety of direct and indirect restrictions on lobbying and political activities. Different restrictions apply depending upon whether a particular activity is considered lobbying or a political activity and upon the type of organization engaging in the activity. Religious, charitable and educational organizations, which are exempt under section 501(c)(3) of the Code and are eligible to receive tax deductible charitable contributions, are subject to the most stringent restrictions.

Lobbying Activities

Section 501(c)(3) Organizations (other than Private Foundations)

In General. Section 501(c)(3) of the Code provides tax exempt status for religious, charitable, educational and certain other categories of organizations. These organizations (other than private foundations which are also exempt under section

501(c)(3)) are often referred to as "public charities". Contributions to these organizations are generally deductible for federal income, estate, and gift tax purposes. In order to be recognized as tax exempt under section 501(c)(3), the organization claiming the exemption is required to file an application with the Internal Revenue Service (the "Service"). If an organization satisfies the requirements of section 501(c)(3), the Service issues a ruling or determination letter to the organization, recognizing its exempt status. In order to assist contributors, the Service periodically publishes a list of exempt organizations that are entitled to receive tax deductible contributions. If an organization is on the current list, contributions to the organization will in most instances be deductible even if, at a later date, the organization loses its exempt status. Organizations seeking tax exempt status under provisions of the tax law other than section 501(c)(3) usually seek a ruling from the Service, but are not required to do so.

Since 1934, the law has provided that otherwise qualifying organizations are not exempt under section 501(c)(3) unless "no substantial part of the activities of [the organization] is carrying on propaganda or otherwise attempting to influence legislation". If an organization is recognized as exempt under section 501(c)(3) and subsequently engages in substantial lobbying activities, its exempt status will be revoked, effective as of the date it first engaged in substantial lobbying.

Definition of Lobbying. Under existing Treasury regulations, an organization is regarded as attempting to influence legislation if it: "(a) contacts, or urges the public to contact, members of a legislative body for the purpose of proposing, supporting or opposing legislation or (b) advocates the adoption or rejection of legislation." "Legislation" includes action by Congress, by any State legislature, by local governing bodies, or by the public in a referendum, initiative, constitutional amendment or similar procedure. It is not relevant whether the lobbying activity will help further an exempt purpose of the organization.

Not every activity that could have a bearing on legislation is viewed as lobbying. Under certain circumstances, study, research and discussion of matters pertaining to public affairs, and even to specific legislation, may be treated as educational activities rather than as attempts to influence legislation. For example, the Service has ruled that an organization established to study, research, and assemble materials on prospective court reform legislation and to distribute such material to the public was engaged in an educational activity and thus qualified for exemption under section 501(c)(3). Rev. Rul. 64-195, 1964-2 C.B. 138. In addition, the Service has ruled that an organization conducting research and discussions regarding the problems of a metropolitan area, but not specifically proposing legislation, is exempt from tax under section 501(c)(3) even though some of the policies formulated by the organization could only be carried out by legislative action. Rev. Rul. 70-79, 1970-1 C.B. 127. Finally, the Service has ruled that an educational institution is not engaged in prohibited legislative activity if, at the request of a legislative committee, a representative testifies on pending legislation. Rev. Rul. 70-449, 1970-2 C.B. 111. As illustrated by these rulings, there is no bright line distinguishing between "lobbying" and a permissible activity such as an "educational" discussion of social policy.

Substantial Part Test. The meaning of the term "no substantial part" as used in section 501(c)(3) to limit lobbying activity has been the subject of considerable debate since the enactment of the provision in 1934. In Seasongood v. Commissioner, 227 F.2d 907 (6th Cir. 1955), the Sixth Circuit

Court of Appeals held that where an organization devoted less than five percent of its time and efforts for legislative activities, such activities were not substantial. However, in Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849 (10th Cir. 1972), cert. denied, 414 U.S. 864 (holding that a church failed to qualify for section 501(c)(3) status because of substantial lobbying and political activity), the Tenth Circuit Court of Appeals found that "a percentage test to determine whether the activities were substantial obscures the complexity of balancing the organization's activities in relation to its objectives and circumstances." Id. at 855. In Haswell v. United States, 500 F.2d 1133 (Ct. Cl. 1974), cert. denied, 419 U.S. 1107 (1975), the Court of Claims used both a percentage of expenditures test and an examination of whether legislation was one of the primary purposes of the organization to hold that the organization in question engaged in substantial legislative activity. (The organization in Haswell was organized to promote rail passenger services, operations and facilities; its legislative expenditures during the years in question ranged from 16.6 percent to 20.5 percent of its total budget.)

Elective Expenditure Test. In 1976, Congress was concerned that the "substantial part" test was so vague and uncertain that charitable organizations were unable to determine the limits of permissible lobbying activity. In addition, some believed that the vagueness of the substantial part test could encourage subjective and selective enforcement.

In response to these concerns, Congress enacted Code sections 501(h) and 4911. Under these provisions, a section 501(c)(3) organization (with certain exceptions, including churches and private foundations) may elect to be subject to a mechanical test, based on expenditures, for determining a permissible level of lobbying. The permissible level of lobbying (the "lobbying nontaxable amount") is based on a sliding scale, ranging from 20 percent of the first $500,000 of exempt purpose expenditures (i.e., charitable, educational, etc. expenditures) down to 5 percent of exempt purpose expenditures in excess of $1,500,000, with a cap on the lobbying nontaxable amount of $1,000,000. "Grass roots" lobbying (the "grass roots nontaxable amount") may not constitute more than 25 percent of the total lobbying nontaxable amount.

In order to prevent organizations from using a group of affiliated organizations to avoid the effect of the sliding scale of limitations, section 4911 generally treats the members of an affiliated group as one organization for purposes of computing the expenditure limitations. For purposes of section 4911, two organizatons are treated as affiliated if (1) the governing instrument of one organization requires it to be bound by decisions of the other organization on legislative matters, or (2) the governing board of one organization includes persons who are designated members (or are key persons) of another organization and such persons have sufficient voting power to prevent legislative action by the first such organization.

For purposes of this expenditure test, section 4911(d) of the Code broadly defines lobbying as any attempt to influence any legislation through: (1) an attempt to affect the opinions of the general public or any segment thereof ("grass roots" lobbying); or, (2) through communication with any members or employees of a legislative body, or with any government official or employee who may participate in the formulation of the legislation ("direct lobbying"). The statute expressly excludes the following from the definition of lobbying: (1) making available the results of nonpartisan analysis, study or research; (2) providing technical advice or assistance in response to a written request from a governmental body or committee or other subdivision; (3)

appearances before, or communications to, any legislative body with respect to a possible decision of such body which might affect the existence of the organization, its powers and duties, tax-exempt status, or the deduction of contributions to the organization; (4) communications between the organization and its bona fide members with respect to legislation or proposed legislation of direct interest to the organization and such members if the communications do not directly encourage lobbying or grass roots lobbying; and (5) communications with government officials other than members or employees of a legislative body, (e.g., officials in the executive branch), unless the principal purpose of the communication is to influence legislation.

An organization that elects the expenditure test is subject to a 25 percent excise tax on any lobbying expenditures in excess of the lobbying nontaxable amount or, if greater, any grass roots lobbying expenditures in excess of the grass roots nontaxable amount. An electing organization's exempt status is revoked if it "normally" (that is, on average over a four year period) makes lobbying expenditures in excess of 150 percent of the lobbying nontaxable amount or grass roots expenditures in excess of 150 percent of the grass roots nontaxable amount.

On November 5, 1986, the Treasury Department published proposed regulations under section 501(h), section 4911, and related sections.[1] In general, these proposed regulations would further define lobbying and provide rules for determining what expenditures are treated as lobbying expenditures. The proposed regulations deal with a number of difficult issues and are currently the subject of vigorous public debate. The public comment period terminates on April 3, 1987, and a public hearing has been scheduled for May 11, 1987.

Prohibition Against Becoming A Social Welfare Organization. An organization that cannot qualify for exempt status under section 501(c)(3) because it intends to engage in substantial lobbying activities may qualify as a social welfare organization under section 501(c)(4). A social welfare organization, contributions to which are not deductible for federal income, estate, and gift tax purposes, is defined as an organization primarily engaged in promoting the common good and general welfare of the people of the community.

In 1976, in addition to being concerned about the vagueness of the "substantial part" test, Congress was concerned that a section 501(c)(3) organization could establish a large endowment through deductible contributions and, if it lost its section 501(c)(3) status because of excessive lobbying, could then qualify as a social welfare organization under section 501(c)(4). Although it would no longer be entitled to receive tax deductible contributions, the income on its endowment would remain exempt. To prevent this abuse of section 501(c)(3) status, Congress enacted section 504 of the Code which prohibits an organization that has lost its section 501(c)(3) status because of excessive lobbying from qualifying for tax exempt status as a section 501(c)(4) organization. Section 504 was intended to ensure that such an organization would be subject to tax until such time as it could regain its section 501(c)(3) status through reapplication to the Service. The Treasury Department is specifically granted regulatory authority to prevent avoidance of section 504, including the authority to promulgate regulations dealing with direct and indirect transfers among commonly controlled organizations. The regulations proposed by Treasury on November 8, 1986, noted above, also contain rules under this provision.

---

[1] Proposed regulations have no legal authority until they are published in final form.

Affiliated Organizations. A section 501(c)(3) organization that desires to engage in substantial lobbying may establish a separate section 501(c)(4) organization. Typically, the section 501(c)(3) organization, which is entitled to receive tax deductible contributions, carries on research and educational activities while the section 501(c)(4) organization carries on lobbying activities. Such an arrangement is permissible under present law so long as separate books are kept and expenses are properly allocated between the two organizations.

Under section 482 of the Code, the Service has the authority to reallocate expenses between exempt organizations under common control in order to reflect accurately the substance of their dealings. For example, if a section 501(c)(3) organization conducts research and prepares an extensive report for the use of a lobbying effort carried on by a section 501(c)(4) organization, at least part of the cost of the research and the report should be allocated to the section 501(c)(4) organization. If the organizations have not properly allocated expenses, the misallocation of expenses could be viewed as a contribution by the section 501(c)(3) organization to the section 501(c)(4) organization in order to carry on lobbying activities, thus subjecting the section 501(c)(3) organization to loss of its exempt status if the activity is substantial. Alternatively, the misallocation of expenses could be viewed as a loan to the section 501(c)(4) organization, in which case repayment of the loan could be required. Cf. Rev. Proc. 65-17, 1965-1 C.B. 833.

Private Foundations

In general, private foundations are organizations described in section 501(c)(3) (with certain exceptions including churches, hospitals and educational institutions) that are primarily supported by a small number of contributors and do not receive substantial support from the general public. Private foundations are subject to more stringent rules with respect to lobbying activities than are other section 501(c)(3) organizations.

Since 1969, all lobbying expenditures by a private foundation have constituted "taxable expenditures" under section 4945 and, as such, are subject to a two-tier excise tax. The first tier consists of a tax equal to 10 percent of the amount of the expenditure, levied on the foundation, and a 2 1/2 percent tax (with a cap of $5,000) levied on the management of the foundation if it knew that the expenditure was a taxable expenditure. In any case in which the first tier tax is levied on the foundation, and the expenditure is not "corrected" in a timely manner, a second tier tax is imposed on the foundation equal to 100 percent of the amount of the expenditure. If the management of the foundation fails to implement the required correction, a tax equal to 50 percent of the expenditure is imposed on the management (with a cap of $10,000). Treasury regulations provide that correction of an expenditure means recovery of the expenditure to the extent possible. Where full recovery is impossible, the Commissioner may prescribe other corrective action including requiring that no further grants to the particular grantee be made, that the foundation make additional reports to the Service, and that improved expenditure procedures be implemented by the foundation.

Section 4945 contains a definition of lobbying that is similar to that in section 4911, discussed above.

If a private foundation incurs excise tax liability as a result of engaging in either willful repeated acts, or a willful and flagrant act (or failures to act), its private foundation status may be terminated and it may be subject to a termination tax. Generally, the phrase "willful repeated acts or failures to act" means at least two voluntary, conscious or intentional acts or failures to act. The termination tax is the lower of the aggregate tax benefit resulting from the private foundation's section 501(c)(3) status or the value of the net assets of the foundation. The Service may abate all or a portion of the termination tax if the private foundation transfers all of its assets to one or more public charities which have been in existence for a continuous period of 60 months or more or if the private foundation gives effective assurance to the Service that its assets will be used for charitable purposes.

Other Exempt Organizations

No direct limitations are placed on the lobbying activities of exempt organizations other than those described in section 501(c)(3). Social welfare organizations, labor unions, trade associations and veterans' organizations may, and often do, engage in extensive lobbying.

An organization is exempt under section 501(c)(4) as a social welfare organization if it is primarily engaged in promoting the common good and general welfare of the community. A social welfare organization may engage in substantial lobbying as long as it is related to its exempt purpose. Further, an organization may be exempt as a social welfare organization if its primary objective may be attained only by the passage or defeat or legislation, and it advocates or campaigns for such legislation. As noted above, however, contributions to social welfare organizations are not deductible.

Similarly, there is no direct limitation on lobbying activities of labor unions (which are exempt under section 501(c)(5)) and trade associations (which are exempt under section 501(c)(6)). Lobbying activities of these organizations, however, may have tax consequences to their members. Section 162(e)(1) provides that ordinary and necessary business deductions include expenses paid or incurred for certain direct communications with legislators, and communications between organizations and their members, concerning legislation of direct interest to the taxpayer. Section 162(e)(2)(B), however, prohibits the deduction of expenses for grass roots lobbying. Existing Treasury regulations provide that if a substantial part of the activities of an exempt organization such as a labor union or a trade association consists of lobbying, other than certain permitted communications with legislators and members, a deduction is allowed only for that portion of the dues that the taxpayer can clearly establish is attributable to non-lobbying (or to permissible lobbying) activities of the organization. Thus, for example, if a company pays $200 dues to a trade association, and one-half of the trade association's activities consist of grass roots or other impermissible lobbying, then only one-half of the dues, or $100, will be deductible.

Finally, no direct limitation is placed on the lobbying activities of veterans' organizations which are exempt under section 501(c)(19). These organizations, however, qualify for tax deductible contributions.

Political Activities

The restrictions on political activities of tax exempt organizations are somewhat different than the restrictions that apply to legislative or lobbying activities.

Section 501(c)(3) Organizations (Other Than Private Foundations)

An organization cannot qualify for tax exemption under section 501(c)(3) if it "participate[s] in, or intervene[s] in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office." Treasury regulations provide that participation in a campaign includes, but is not limited to, spoken or written statements on behalf of or in opposition to a candidate.

Some activities that involve political campaigns are, nevertheless, permitted by this provision, either because they are viewed as nonpartisan and thus educational or because the activity is not attributed to the organization. Certain voter education activities, if carried on in a nonpartisan manner, do not constitute intervention in a political campaign. For example, the Service ruled that an organization that prepared and made available to the public an annual compilation of the voting records of all members of Congress on major legislative issues was exempt under section 501(c)(3). Rev. Rul. 78-248, 1978-1 C.B. 154. The Service has also held that if an exempt educational institution offers a political science course that requires involvement of the students in a political campaign of their choice, or if the institution supports a student newspaper that expresses editorial opinions on elections, the institution itself is not involved in prohibited political activity. Rev. Rul. 72-512, 1972-2 C.B. 246; Rev. Rul. 72-513, 1972-2 C.B. 246.

Private Foundations

The restrictions on political activities of private foundations are similar to the restrictions on lobbying activities of private foundations. Since 1969, any amount paid or incurred by a private foundation to influence the outcome of any public election, or to carry on, directly or indirectly, any voter registration drive (except as provided in section 4945(f)) has been treated as a taxable expenditure. A voter registration drive is permitted if it is nonpartisan, if it is carried on in five or more states, if the organization running the drive meets certain expenditure and support tests, and if contributions for the drive are not earmarked for specified states (or political subdivisions) or for a specific election period. The private foundation sanctions for political expenditures are the same as for lobbying expenditures -- *i.e.*, a two-tier tax on the foundation and its management, with the correction of any prohibited expenditure required in order to avoid the second tier tax. Termination of private foundation status and imposition of a termination tax, as described above, is also a possible sanction.

Other Exempt Organizations

There is no direct limitation on participation in political activities by exempt organizations other than those described in section 501(c)(3). However, an organization would not satisfy the definition of any of the 25 organizations described in section 501(c) and, thus, would not qualify as exempt if its primary activities involved participation in political campaigns. Treasury regulations expressly provide that the promotion of social welfare does not include political campaign activity. In addition, as explained below, any section 501(c) organization that engages in political activities is subject to tax on its investment income to the extent of its political expenditures.

As is the case with lobbying activities by exempt organizations such as labor unions or trade associations, participation in political activities by such organizations cause a portion of the dues paid by the members to be nondeductible (if the combined lobbying and political activity is substantial).

Political Organizations

Section 527 of the Code governs the taxation of political organizations. A political organization is, in general, any organization created and operated primarily for accepting contributions and making expenditures for the purpose of influencing the election or appointment of an individual to a public office or office in a political organization. A political organization is exempt from taxation on its income from contributions, dues, fundraising events and bingo, but is subject to tax on its other income such as investment income. The tax rate is the maximum corporate rate, unless the organization is a principal campaign committee of a Congressional candidate, in which case the graduated corporate rates apply. Contributions to a political organization are not deductible for federal income, gift, and estate tax purposes. In addition, they are not subject to gift tax.

If an organization described in section 501(c) engages in political activity, the organization is subject to tax under section 527 on the lesser of the amount of political expenditures or the organization's net investment income. A section 501(c) organization may maintain a segregated fund for political activities in which case the segregated fund is treated under section 527 as a separate political organization. Contributions to a segregated fund are not deductible. The legislative history of section 527 indicates the provisions were not intended to affect in any way the prohibition against participation in political activities by section 501(c)(3) organizations or the tax on private foundations that engage in political activities. Thus, establishment of a segregated fund by a section 501(c)(3) organization results in loss of the organization's exempt status.

DISCUSSION

Basic Policy

Exempt organizations play a vitally important role in our society. The numerous religious, charitable, and educational institutions in our country contribute to and enrich virtually every aspect of American life. These organizations do far more than simply "lessen the burdens of government," one of the traditional policy rationales for tax exemption, for they provide an abundance of diverse services and new ideas that no government could provide.

Notwithstanding the importance of these institutions to our society, present law reflects a Congressional judgment that in the matters of political campaigns and substantial lobbying activities the subsidy of tax deductible contributions generally should be denied. In the words of Judge Learned Hand, "controversies of that sort must be conducted without public subvention; the Treasury stands aside from them". Slee v. Commissioner, 42 F.2d 184 (2d Cir. 1930).

Lobbying Activities

The rationale for the current restrictions on lobbying activities has never been clearly articulated. The current restriction on lobbying activities by section 501(c)(3) organizations was added to the tax law in 1934 by a Senate floor amendment. The legislative history regarding the amendment is inconclusive as to the purpose and scope of the provision, but suggests that one of the reasons for enacting the provision was to deny a tax deduction for contributions made to serve the "selfish" and "personal" interests of the donor.

Although the general rule is that organizations eligible to receive tax deductible contributions may not engage in substantial lobbying, the overall statutory scheme is not entirely consistent. For example, veterans' organizations exempt under section 501(c)(19) of the Code are not subject to restrictions on lobbying, although they are entitled to receive tax deductible contributions. Moreover, under section 162(e), business deductions are disallowed entirely for grass roots lobbying, but are allowed without restriction for direct lobbying on matters of direct interest to the taxpayer. Section 501(c)(3) organizations, by contrast, are generally allowed to engage in both direct and grass roots lobbying to some extent. Private foundations, however, are not allowed to lobby at all without incurring a tax.

The basic rules regarding lobbying by tax exempt organizations have received significant consideration by Congress during the past 20 years. The rules with respect to private foundations were the subject of careful deliberation prior to the enactment of the current rules in 1969. In 1983, this Subcommittee reviewed the private foundation rules and did not recommend any changes in this area. With respect to public charities, lobbying activities were the subject of extensive discussion in Congressional hearings in the early 1970s. Some suggested that public charities should not be allowed to engage in grass roots lobbying at all but rather, like businesses, should be allowed to engage only in direct lobbying on matters directly related to their exempt purposes. Such a rule, it was argued, would create a more equitable balance between the tax treatment of exempt organizations and businesses engaging in lobbying. Others suggested that some restrictions should be imposed on the type of direct lobbying in which public charities could engage. In 1976, when Congress enacted the expenditure test and other provisions relating to lobbying by public charities, it struck a balance that permits section 501(c)(3) organizations to engage in both grass roots lobbying and direct lobbying, but continues to restrict the extent of their lobbying activities.

Although a conceptual argument may exist for more parallel treatment of legislative activities of businesses and section 501(c)(3) organizations, Congress has not followed this approach in the past. Moreover, there would be a substantial revenue impact associated with a liberalization of the amount of direct lobbying permitted by section 501(c)(3) organizations, because organizations presently exempt under section 501(c)(4) could convert to section 501(c)(3) status, and thereby become eligible to receive tax deductible contributions. In light of these factors, and recognizing that present law represents a compromise among competing views, the Treasury Department does not recommend changes in the restrictions on lobbying by exempt organizations.

Political Activities

As with the restriction on lobbying activities, there is little legislative history regarding Congressional intent in enacting the prohibition against political campaign activities by section 501(c)(3) organizations. The prohibition was added by a Senate floor amendment to a bill which became the Internal Revenue Code of 1954.

The complete prohibition against political campaign activities by section 501(c)(3) organizations is sound tax policy. There is little to be said in favor of a general government subsidy of political campaigns by means of allowing tax deductible contributions to organizations participating in such campaigns. It would be difficult to describe most political campaigns as either charitable or educational endeavors, or even as a direct means of furthering one of the exempt purposes described in section 501(c)(3). Hence, the Treasury Department supports continuation of this prohibition.

While the Treasury Department does not recommend a change in the basic statutory scheme with respect to lobbying or political activities by tax exempt organizations, there are a number of specific issues that warrant Congressional attention.

Affiliated Exempt Organizations

As described above, a group that intends to engage in both educational and substantial lobbying activities may establish separate organizations. Typically, one organization is established under section 501(c)(3) to receive tax deductible contributions and to carry on educational activities, and a second organization is established as a social welfare organization under section 501(c)(4) to engage in lobbying activities. Such arrangements are clearly permissible under current law as long as separate books are kept by the organizations. Nevertheless, such arrangements create difficult administrative problems for both taxpayers and the Service. The primary problem is the proper allocation of expenses between the two organizations.

Affiliated organizations often share facilities, staff, and equipment. Allocating such expenses to the proper organization is in some cases not an easy matter for either taxpayers or the government. The difficulties are exacerbated by a fundamental tension in the law. A section 501(c)(3) organization receives tax deductible contributions but its lobbying activities are limited to an insubstantial part of its total activities. In contrast, a section 501(c)(4) organization is not limited in its lobbying activities but is not entitled to receive tax deductible contributions. Thus, the law creates an incentive to allocate expenses to the section 501(c)(3) organization rather than to the section 501(c)(4) organization. For example, a section 501(c)(4) organization that is planning a lobbying campaign may have an affiliated section 501(c)(3) organization conduct research and prepare reports with a view to using such reports for lobbying. The organizations may allocate all of the research expenditures to the section 501(c)(3) organization and allocate only the cost of making direct contacts with legislators or members of the public to the section 501(c)(4) organization. A comparable situation exists when a section 501(c)(3) organization is affiliated with a section 527 political organization of a candidate for public office. Such section 501(c)(3) organizations may be used to research issues, prepare position papers, and sponsor "educational" forums at which the candidate is one of the principal speakers.

In order to enforce the requirement that affiliated organizations keep separate records and make reasonable allocations, the Service must be able to conduct a coordinated audit of the affiliated organizations. Under current law, this is difficult if not impossible. Despite their affiliation, the organizations in the examples described above file separate returns and in some circumstances may not disclose the extent to which the section 501(c)(3) organization has assisted the section 501(c)(4) or section 527 organization. Although Form 990, "Return of Organization Exempt from Income Tax," contains a question as to whether the organization is affiliated with any other organization, the question has failed to elicit useful responses for at least two reasons. First, there is no statutory definition (of general application) of affiliated exempt organizations. Second, there is no specific penalty for failure to disclose the names of affiliated organizations.

The ability of the Service to audit affiliated exempt organizations would be significantly improved by legislation. The Treasury Department suggests that the Subcommittee consider: (1) a statutory definition of affiliated exempt organizations; (2) a statutory requirement that organizations that meet the statutory definition of affiliation disclose the names and taxpayer identification numbers of affiliated organizations; and, (3) appropriate penalties for failure to provide this information. The definition of affiliated organizations in section 4911, which applies to organizations electing to be covered by the expenditure test under section 501(h), could provide a starting point for such a definition.

While these suggestions would improve the ability of the Service to deal with abusive situations, other more subtle issues also arise from the use of related organizations. Under current law, for example, individuals are permitted artificially to divide interrelated activities that share a common objective among separate organizations. Even if separate books are kept and expenditures are reasonably allocated among the organizations, the activity of one organization complements, and thus benefits, the activities of the other organizations. For example, a candidate for political office (or an individual who is considering running for political office) receives indirect benefits when a related section 501(c)(3) organization conducts research and sponsors forums on issues that will be important to the candidate's campaign or when a section 501(c)(4) organization engages in lobbying activities on positions that the candidate has taken or expects to take in his campaign.

Since the tax law is structured to prohibit the use of tax deductible contributions and tax free investment income for private benefit or for political activity, such arrangements raise important issues of tax policy. Such arrangements may also raise important issues concerning the federal election laws. For example, the Federal Election Campaign Act ("FECA") imposes limits on the amount that persons may contribute annually to political organizations, requires disclosure of certain contributions, and prohibits corporations and labor unions, among others, from making contributions to political organizations. Some exempt organizations may be attempting to avoid the FECA rules through the use of section 501(c)(3) or 501(c)(4) organizations. Neither current law nor the suggestions above attempt to deal with these issues. Moreover, at this time the Treasury Department does not have specific data concerning the extent to which affiliated organizations are used to take advantage of the section 501(c)(3) status of one of the affiliates. The Treasury Department believes, however, that these issues raises important questions of public policy as well as tax policy and would be happy to work with the Subcommittee to study the matter further.

Sanctions

Lobbying Activities

As noted above, if a section 501(c)(3) organization does not elect to be subject to the expenditure test, it is subject to loss of tax exempt status if it engages in substantial lobbying activities. Because of the vagueness of the "substantial part" test, the test provides little guidance to taxpayers and is difficult for the Service to administer. A vague standard is particularly troublesome in this situation because the only available sanction -- revocation of tax exempt status -- is sometimes unduly harsh. Moreover, the vagueness of the standard and the harshness of the sanction leave the Service open to accusations of politically motivated enforcement.

The elective expenditure test under section 501(h) represents a significant improvement over the substantial part test. Admittedly, an expenditure test is not necessarily the best measure of the extent of an organization's lobbying activities in all cases. In addition, even though the dollar amount of permissible lobbying is a precise standard, it must be applied to an activity that is difficult to define and that raises difficult allocation issues. However, while the expenditure test is not perfect from a theoretical standpoint and is not entirely precise, on balance it represents a reasonable and objective measure of lobbying activities.

The imposition of excise taxes on organizations that exceed the applicable limits under the expenditure test, with revocation of exempt status reserved as a sanction for those organizations that exceed the limits by a significant amount over a period of several years, is a considerable improvement over the substantial part test. The imposition of an excise tax is a more appropriate sanction for initial violations and provides fair warning, prior to revocation of exempt status, to organizations that are engaging in impermissible levels of lobbying activities.

Political Activities

As previously stated, under current law the only sanction for engaging in political activities is revocation of tax exempt status. Unlike the restriction on lobbying, the prohibition on participation in political activities is absolute and thus does not raise problems of measuring the level of the activity. Further, political activity is somewhat easier to define than lobbying activity. Even though the standards are more precise than with respect to the rules on lobbying, revocation of tax exempt status may still be unduly harsh in some instances. In other cases, such as where an organization has expended all its funds, it may have little or no impact on an organization.

The Treasury Department suggests that, in lieu of automatic revocation of exempt status, the Subcommittee consider the imposition of an excise tax on public charities that engage in political activities. Such a tax should be similar to the excise tax that is imposed on private foundations under section 4945. Thus, a tax should be imposed both on the organization and on the management of the organization if it acted with knowledge that the expenditure was for political activities. Also, the statute should require correction of the prohibited expenditure either by recovery of the money or by such other means as the Commissioner may prescribe. Absent correction of the expenditure, or in cases of repeated or flagrant violations, the organization should be subject to loss of its exempt status.

Successor Organizations

Problems similar to those created by the use of affiliated exempt organizations also exist with successor organizations. Although section 504 of the Code, discussed above, prevents a section 501(c)(3) organization that has lost its exempt status because of substantial lobbying from becoming a section 501(c)(4) organization, it may be possible to circumvent the prohibitions against lobbying and political activities through the use of a series of section 501(c)(3) successor organizations.

For example, a group of individuals may establish a section 501(c)(3) organization, collect tax deductible contributions on behalf of the organization, and expend all of the organization's funds on lobbying or political activities. The group would then establish another organization, possibly with the same or a similar name, again collect contributions, and expend all of the second organization's funds, and so on. By the time the Service completes an audit of the first organization, it is a mere shell and the second organization has become the operative entity. This technique could be used indefinitely.

When an organization's exempt status is revoked, it is treated as a taxable organization until it can satisfy the Commissioner that proper precautions have been taken so that the organization will not again engage in substantial lobbying or political activities. A successor organization to one that has lost its exempt status because of excessive lobbying should be treated no more favorably. Present law, however, creates difficulties for the Service in tracing a series of successor organizations.

Although the Service could obtain information about predecessor organizations through a question on Form 1023, "Application for Recognition of Exempt Status Under Section 501(c)(3)," and could arguably treat a series of organizations as one, its ability to deal effectively with successor organizations would be enhanced by legislation. Accordingly, the Treasury suggests that the Subcommittee consider legislation that would: (1) require organizations applying for recognition of exempt status to disclose the names and taxpayer identification numbers of any "affiliated" organization (using the definition of general application discussed above) either currently in existence or in existence during a preceding period of, for example, five years; and, (2) impose appropriate penalties for failure to provide such information.

Possible Sanctions Upon Revocation of Exempt Status

Notwithstanding the foregoing recommendations, the Treasury Department remains concerned that for some organizations loss of exempt status is an ineffective sanction. This is especially the case with short-lived organizations that realize a substantial tax benefit from the ability to receive deductible contributions but have very little to lose if the contributed money is expended for a prohibited purpose such as substantial lobbying activities. It would be impractical and unfair to seek to recover the tax benefit of these past deductions from the contributors to the organization. The Subcommittee might, however, wish to consider some form of additional sanction on organizations that lose their exempt status because of political or substantial lobbying activities. Such a sanction could include a monetary penalty on the organization or possibly a fine on the managers of the organization who knew of, or were responsible for, the impermissible conduct. Because of the vagueness of the "substantial part" test of section 501(c)(3), some form of preliminary, or warning, sanction could also be imposed in appropriate cases.

CONCLUSION

As described in greater detail above, the Treasury recommends consideration of the following changes to current law: (1) a statutory definition and required disclosure of affiliated exempt organizations on information returns with appropriate penalties for failure to provide such information; (2) an excise tax on section 501(c)(3) organizations that participate in political activities; and (3) required disclosure of current or past affiliated organizations on applications for recognition of exempt status. Further, consideration might be given to whether sanctions in addition to revocation of exempt status would be appropriate for organizations that lose their exempt status because of political activity or substantial lobbying. Treasury would be pleased to work with the Subcommittee and its staff to develop such proposals in greater detail.

This concludes my prepared testimony. I would be happy to answer any questions.

Chairman Pickle. Well, I thank you, Mr. Secretary. I appreciate your cooperation this morning, and I know you recognize that this is an involved policy matter that Congress working with the Department, and with all the organizations must work on. I appreciate your assistance and coordination.

I'm going to ask now, Commissioner Gibbs to make such statements as he'd care to make. I have a question for you, Mr. Secretary, but I think there will be questions for you as well as Mr. Gibbs, so we'll try to do them together. So, Commissioner Gibbs, if you'd proceed.

STATEMENT OF HON. LAWRENCE B. GIBBS, JR., COMMISSIONER OF INTERNAL REVENUE

Mr. Gibbs. Thank you, Mr. Chairman. To you and other members of the subcommittee, I would like to say that I welcome this opportunity to report on the Service's administration of the tax laws governing lobbying and political activities by charitable and other tax-exempt organizations.

The tax laws in this area affect numerous kinds of organizations, covering the entire political and ideological spectrum, and they involve very difficult issues of interpretation as we've already heard this morning.

As the tax administrator, I am pleased, Mr. Chairman, with your statement in announcing this hearing that you intend to take a hard look at what organizations are doing and what the law allows.

I am going to curtail my statement because of the discussion that we've previously had, and I'd like to deal primarily with our enforcement program in the exempt organizations area. It will not take long.

The Service has an active examination program in the exempt organizations area. As has been mentioned already this morning, we examine approximately 20,000 out of the 400,000 returns that are filed annually, and that is about a 5 percent audit coverage of the entire spectrum.

The Service selects exempt organization returns for examination from four independent sources. Most returns that are selected are based on a computer scoring system that is similar to that that we use in the income tax area. This computer scoring system is based on information that is furnished on the annual tax returns that exempt organizations file, the form 990.

A second selection category is our Taxpayer Compliance Measurement Program or TCMP for short, that relates specifically to exempt organization returns. This is a scientifically designed random sample of returns that are audited in detail.

Now the results of our TCMP examinations form the basis for the computer scoring approach that I mentioned previously. In other words, we do the TCMP, which is a detailed audit; we obtain the information, and then we use that to score the returns that we actually and normally select under the first approach that I mentioned.

The TCMP program is designed to assist the service in identifying the overall level of compliance by tax-exempt organizations and also to assist us in how we allocate our resources.

The most recent TCMP examinations in the exempt organizations area were conducted during the period from 1980 to 1985, and their results were incorporated in the computer scoring that was performed after January 1 of last year, January 1, 1986.

A third source of our examinations is input from the public. As in the income tax area, the Service receives information from a multitude of sources, including the public, the media, and the Congress, suggesting that a particular organization may be carrying on a nonexempt activity or doing something that we should look into. Information of this sort finds its way to our district offices, which evaluate the information and decide whether an examination is warranted.

I'd like to emphasize that the decentralization of responsibility for making decisions on whether or not to conduct an examination with respect to information of this sort is intentional, and it is historical. It is designed to minimize any possibility of political influence and is a policy of longstanding duration that was formulated when the Service was reorganized in the early 1950s as a result of the King and Keane committee hearings here in Congress.

The fourth source of examinations in the exempt organizations area is our so-called special emphasis programs. At various times, the special emphasis is placed on a particular area where there are indications of possible noncompliance, often based on congressional inquiries and interest. For example, a greater concentration of resources has been used in past years to examine private foundations, private schools, grassroots lobbying activities, and currently the administrative expenses of private foundations.

Based upon our audit coverage, we believe that our resources are not the problem in enforcing this area. Rather we believe the key problems in this area of tax-exempt organizations relate to issues concerning the charitable affiliates of the noncharity, the lack of appropriate sanctions in certain cases, and certain definitional questions.

Now because Mr. Mentz, in his testimony, has covered these three areas—the affiliated organizations, the sanctions issue, and the definitional issues—I will not again go into them.

I will simply conclude by saying that over the years, the area of lobbying and political activity by exempt organizations has been a highly sensitive one. It is a seedbed for taxpayer controversy.

Under current law, the potential for tax abuses exists, and there is little risk of penalty on the organizations, its managers, and its contributors for many of the violations.

Overall, we believe that clear guidance to specify the limits of permissible activity, along with more appropriate sanctions for violations, is administratively desirable. We hope that you will find it suitable to provide remedies to some of the administrative difficulties in this area along the lines of prior congressional enactments and also the proposals that Mr. Mentz made earlier this morning.

With the Treasury Department, I look forward to working with the subcommittee as it conducts its review of the area and as it may seek additional legislative remedies.

This concludes my testimony, and I will be happy to answer questions.

[The prepared statement follows:]

STATEMENT OF
LAWRENCE B. GIBBS
COMMISSIONER OF INTERNAL REVENUE
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
HOUSE WAYS AND MEANS COMMITTEE

MARCH 12, 1987

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

GOOD MORNING. AS COMMISSIONER, I TRULY WELCOME THIS OPPORTUNITY TO REPORT ON THE SERVICE'S ADMINISTRATION OF THE TAX LAWS GOVERNING LOBBYING AND POLITICAL ACTIVITIES BY CHARITABLE AND OTHER TAX-EXEMPT ORGANIZATIONS. THE TAX LAWS IN THIS AREA AFFECT NUMEROUS KINDS OF ORGANIZATIONS, COVERING THE ENTIRE POLITICAL AND IDEOLOGICAL SPECTRUM, AND INVOLVE DIFFICULT ISSUES OF INTERPRETATION THAT SOMETIMES RAISE QUESTIONS OF CONSTITUTIONAL SIGNIFICANCE. AS A TAX ADMINISTRATOR, I AM PLEASED WITH THE CHAIRMAN'S STATEMENT IN ANNOUNCING THIS HEARING THAT HE WILL TAKE A "HARD LOOK" AT WHAT ORGANIZATIONS ARE DOING AND WHAT THE LAW ALLOWS.

ALTHOUGH I HAVE BEEN IN OFFICE AS COMMISSIONER FOR LESS THAN ONE YEAR, THE TAX ADMINISTRATION PROBLEMS OF LOBBYING AND POLITICAL ACTIVITIES BY TAX-EXEMPT ORGANIZATIONS ARE NOT ENTIRELY NEW TO ME. IN THE EARLY 1970'S WHEN I SERVED FIRST AS DEPUTY CHIEF COUNSEL AND THEN AS ASSISTANT COMMISSIONER (TECHNICAL), I HAD OCCASION TO ADDRESS SOME PROBLEMS IN THIS AREA. I HAVE FOUND THAT THEY DID NOT GO AWAY DURING THE LAST TEN YEARS THAT I WAS IN PRIVATE PRACTICE. WHAT I WOULD LIKE TO DO THIS MORNING IS TO DESCRIBE THE FOLLOWING FOR THE SUBCOMMITTEE:

1) THE CURRENT TAX ADMINISTRATION PROBLEMS IN THIS AREA, AND
2) THE EXAMINATION PROGRAM FOR TAX-EXEMPT ORGANIZATIONS.

I. CURRENT TAX ADMINISTRATION PROBLEMS

A. DEFINITIONAL ISSUES RELATED TO LOBBYING OR POLITICAL ACTIVITIES

IN EXAMINING INDIVIDUAL CASES, THE LOBBYING AND POLITICAL ACTIVITIES AREAS INVOLVE MANY AMBIGUITIES. FOR INSTANCE, SEVERAL STATUTORY TERMS ARE INHERENTLY DIFFICULT TO APPLY IN SPECIFIC FACTS AND CIRCUMSTANCES. APPLYING DEFINITIONS OF LOBBYING SUCH AS:

-- "INTERVENING IN ANY POLITICAL CAMPAIGN ON BEHALF OF ANY CANDIDATE FOR PUBLIC OFFICE;"
-- "CARRYING ON PROPAGANDA, OR OTHERWISE ATTEMPTING TO INFLUENCE LEGISLATION;"
-- "ATTEMPTING TO INFLUENCE ANY LEGISLATION THROUGH AN ATTEMPT TO AFFECT THE OPINIONS OF THE GENERAL PUBLIC OR ANY SEGMENT THEREOF;" AND "MAKING AVAILABLE THE RESULTS OF NONPARTISAN ANALYSIS, STUDY, OR RESEARCH"

IS VERY DIFFICULT GIVEN THE NUMEROUS FACT SITUATIONS THAT CAN EXIST IN THE ACTIVITIES OF NON-PROFIT ORGANIZATIONS. NUANCES OF LANGUAGE IN THE ORGANIZATION'S PUBLICATIONS OR TIMING OF THE RELEASE OF A PUBLICATION CAN BECOME FACTORS.

ONCE THE DIFFICULT AND SENSITIVE DETERMINATION HAS BEEN MADE THAT AN ACTIVITY FALLS WITHIN THE SCOPE OF THE LOBBYING OR POLITICAL ACTIVITY RESTRICTIONS OF SECTION 501(C)(3), TWO OTHER MAJOR CONSIDERATIONS WILL OFTEN AWAIT

THE EXAMINING AGENT. IN MANY CASES THERE MAY BE AN ATTRIBUTION PROBLEM, THAT IS, WHETHER THE ACT MAY BE ATTRIBUTED TO AN INDIVIDUAL RATHER THAN THE ORGANIZATION. NUMEROUS CHARITIES AND OTHER NON-PROFITS HAVE OFFICERS WHO MAY, ON OCCASION, CLAIM TO ACT ON THEIR OWN BEHALF RATHER THAN ON BEHALF OF THE ORGANIZATION IN ENDORSING A CANDIDATE OR ENGAGING IN A LOBBYING EFFORT.

SOME FACTORS THAT MAY BE CONSIDERED WOULD BE WHETHER ORGANIZATIONAL STATIONERY WAS UTILIZED; WHETHER AN ORGANIZATIONAL TITLE WAS USED; WHETHER THE EXECUTIVE STATED THAT THE ORGANIZATION WAS NOT INVOLVED AT THE TIME OF THE ACT; WHETHER THE BOARD OF DIRECTORS ENDORSED THE ACT; THE PUBLIC PERCEPTION OF THE ACT; WHETHER THE BOARD OF DIRECTORS DISAVOWED THE ACT; AND WHETHER THE EXECUTIVE NORMALLY ACTED FOR THE ORGANIZATION ON OTHER MATTERS.

EACH INDIVIDUAL CIRCUMSTANCE IS DIFFERENT, BUT ATTRIBUTION PROBLEMS OFTEN DO EXIST, PARTICULARLY WHEN THE CIRCUMSTANCES INVOLVE CLOSELY CONNECTED OR AFFILIATED SECTION 501(C)(3) CHARITABLE AND 501(C)(4) SOCIAL WELFARE ORGANIZATIONS AND POLITICAL ACTION COMMITTEES.

A SECOND MAJOR PROBLEM AFTER A DETERMINATION HAS BEEN MADE THAT LOBBYING OR POLITICAL ACTIVITY HAS OCCURRED, INVOLVES MEASUREMENT OF THE AMOUNT OF THE ACTIVITY. THIS FACTOR IS, OF COURSE, CRUCIAL IN DETERMINING WHETHER AN ORGANIZATION ENGAGED IN SUBSTANTIAL LOBBYING OR, IF THE ORGANIZATION MADE THE SECTION 501(H) ELECTION, WHETHER THE ORGANIZATION REMAINED WITHIN THE NON-TAXABLE EXPENDITURE LIMITS.

IN MEASURING LOBBYING UNDER THE "SUBSTANTIAL PART" TEST AND POLITICAL ACTIVITY, THERE ARE VARIOUS CONSIDERATIONS THAT MAY BE TAKEN INTO ACCOUNT. SOME ACTIVITIES ENGAGED IN BY ORGANIZATIONS MAY HAVE GREAT IMPACT ON THE OPINIONS OF THE GENERAL PUBLIC WITH LITTLE OR NO FINANCIAL INVESTMENT BY THE ORGANIZATION. UTILIZATION OF VOLUNTEERS ALSO MAY RESULT IN SIGNIFICANT IMPACT WITH ONLY VERY MINOR EXPENDITURES BY THE ORGANIZATION.

IN MEASURING QUANTITATIVELY, MANY FACTORS OF ALLOCATION ARE INVOLVED UNDER ANY GIVEN FACTS AND CIRCUMSTANCES OF AN ORGANIZATION. FOR INSTANCE, WHEN AN ACTIVITY INVOLVES BOTH LOBBYING AND EDUCATIONAL OR CHARITABLE PURPOSES, HOW SHOULD AN ALLOCATION BE MADE? NEEDLESS TO SAY, EVEN A REASONABLE ALLOCATION STANDARD IN THIS HIGHLY SENSITIVE AREA WILL NOT ALWAYS RESULT IN AN UNCHALLENGED DETERMINATION. CONSIDERATIONS OF RESEARCH COSTS AND OVERHEAD EXPENSES ARE ALSO INVOLVED. WHEN A PUBLIC CHARITY ELECTS UNDER SECTION 501(H), ADDITIONAL CONSIDERATION INVOLVES DISTINGUISHING BETWEEN DIRECT AND GRASSROOTS LOBBYING, A DISTINCTION WHICH IS NOT MADE UNDER THE "SUBSTANTIAL PART" TEST FOR LOBBYING BY NONELECTING ORGANIZATIONS. HOWEVER, ONLY A QUANTITATIVE ANALYSIS BASED ON EXPENDITURES IS USED WHEN A CHARITY ELECTS UNDER SECTION 501(H) -- A SIGNIFICANT ADVANTAGE OVER THE "SUBSTANTIAL PART" TEST.

ONCE AN EXAMINING AGENT HAS RESOLVED ATTRIBUTION AND ALLOCATION QUESTIONS, HE OR SHE IS THEN FACED WITH COMBINING THESE, BOTH QUALITATIVELY AND QUANTITATIVELY, TO DETERMINE WHETHER THE ORGANIZATION ENGAGED IN SUBSTANTIAL LOBBYING. IF POLITICAL INTERVENTION IS INVOLVED, THE PROHIBITION IS ABSOLUTE; HOWEVER, SOME CONSIDERATION MAY BE GIVEN TO WHETHER, QUALITATIVELY AND QUANTITATIVELY, THE ORGANIZATION IS IN THE CIRCUMSTANCE WHERE THE ACTIVITY IS

SO TRIVIAL IT IS WITHOUT LEGAL SIGNIFICANCE AND, THEREFORE, DE MINIMIS. THE FEW COURT CASES DISCUSSING THE "SUBSTANTIAL PART" TEST FOR LOBBYING ACTIVITY HAVE GENERALLY CONCLUDED THAT THE FACTS AND CIRCUMSTANCES OF EACH CASE, RATHER THAN SET PERCENTAGES, ARE THE PROPER METHOD OF CONSIDERATION.

B. CHARITABLE AFFILIATES

MANY OF THE ALLOCATION AND ATTRIBUTION FACTORS ADDRESSED ABOVE ARE COMPOUNDED IN THE GROWING AREA OF CLOSELY CONNECTED SECTION 501(C)(3) AND 501(C)(4) ORGANIZATIONS AND POLITICAL ACTION COMMITTEES. MANY OF THESE CLOSELY CONNECTED ORGANIZATIONS OPERATE OUT OF THE SAME OFFICES, UTILIZE THE SAME EMPLOYEES, AND HAVE THE SAME BOARDS OF DIRECTORS. WHEN THE SAME EMPLOYEE WORKS FOR SEVERAL DIFFERENT ORGANIZATIONS THERE IS POTENTIAL FOR ABUSE IN ALLOCATING THOSE EXPENDITURES TO THE VARIOUS ORGANIZATIONS. TAX DEDUCTIBLE CONTRIBUTIONS TO THE SECTION 501(C)(3) ORGANIZATION PROVIDE A STRONG INCENTIVE FOR THE ORGANIZATIONS TO ALLOCATE AS MANY EXPENDITURES AS POSSIBLE TO THE SECTION 501(C)(3) ORGANIZATION. FOR INSTANCE, A SECTION 501(C)(3) ORGANIZATION COULD BE UTILIZED TO DEVELOP AND PERFECT A MAILING LIST THAT COULD BE USED BY A RELATED SECTION 501(C)(4) ORGANIZATION TO SOLICIT MORE ECONOMICALLY AND EFFICIENTLY POTENTIAL DONORS FOR LOBBYING OR POLITICAL PROJECTS.

ONE ESPECIALLY TROUBLESOME ENFORCEMENT PROBLEM OCCURS AFTER THE SERVICE CONCLUDES THAT A PARTICULAR SECTION 501(C)(3) ORGANIZATION ENGAGED IN LOBBYING BEYOND ALLOWED AMOUNTS AND THEN THAT ORGANIZATION SIMPLY GOES OUT OF EXISTENCE, WITH ANOTHER NEWLY CREATED SECTION 501(C)(3) ORGANIZATION TAKING OVER ITS FUNCTION. TYPICALLY, THE ORIGINAL SECTION 501(C)(3) ORGANIZATION WOULD SUFFER LITTLE IF ANY INCOME TAX CONSEQUENCE BECAUSE MOST OF ITS RECEIPTS WOULD NOT BE TAXABLE. ALSO, THE CONTRIBUTORS' TAX DEDUCTIONS FOR CONTRIBUTIONS MADE TO THE ORIGINAL ORGANIZATION IN PRIOR YEARS WILL NOT BE ADVERSELY AFFECTED. ABSENT FRAUD, THERE ARE NO FEDERAL TAXES OR PENALTIES ON THE ORGANIZATION'S MANAGERS.

C. INADEQUACIES OF SANCTIONS FOR VIOLATIONS OF THE SECTION 501(C)(3) PROHIBITIONS ON POLITICAL AND LOBBYING ACTIVITIES

AS NOTED ABOVE, THE SANCTION FOR VIOLATION OF THE PROHIBITIONS ON POLITICAL ACTIVITY AND LOBBYING ACTIVITY UNDER THE "SUBSTANTIAL PART" TEST IS LOSS OF EXEMPTION UNDER SECTION 501(C)(3).

WHEN THE TAX REFORM ACT OF 1969 WAS ENACTED, IT WAS ALREADY CLEAR THAT LOSS OF EXEMPTION WAS AN INAPPROPRIATE SANCTION AT LEAST AS IT APPLIED TO PRIVATE FOUNDATIONS. THE TAX REFORM ACT ADDED SECTION 4945 WHICH IMPOSED AN EXCISE TAX ON PRIVATE FOUNDATIONS' POLITICAL EXPENDITURES. IN AN ANALYSIS OF THE PRE-1969 SITUATION, THE JOINT COMMITTEE'S GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, AT PAGE 47, STATES:

> ANOTHER PROBLEM AROSE FROM THE FACT THAT ABSOLUTE PROHIBITION UPON INVOLVEMENT IN POLITICAL CAMPAIGNS ON BEHALF OF ANY CANDIDATE FOR PUBLIC OFFICE FREQUENTLY RESULTED IN THE ALTERNATIVES OF UNREASONABLY SEVERE PUNISHMENT OR UNREASONABLY LIGHT PUNISHMENT. AS A PRACTICAL MATTER, MANY ORGANIZATIONS OFTEN FOUND WAYS OF MAKING CLEAR THEIR VIEWS REGARDING OPPOSING POLITICAL CANDIDATES WITHOUT FEAR THAT THEIR EXEMPT STATUS WOULD BE REVOKED....

SECTION 4945 ATTEMPTED TO REMEDY THIS SITUATION FOR PRIVATE FOUNDATIONS BY IMPOSING AN EXCISE TAX ON POLITICAL EXPENDITURES.

WHERE A PUBLIC CHARITY VIOLATES THE SECTION 501(C)(3) PROHIBITION ON POLITICAL ACTIVITY, THE SANCTION IS AS INADEQUATE TODAY AS IT WAS FOR PRIVATE FOUNDATIONS PRIOR TO 1969. LOSS OF EXEMPTION IS UNREASONABLY SEVERE WHEN A PROHIBITED ACTIVITY IS NOT EXTENSIVE. FOR EXAMPLE, A PUBLIC CHARITY MIGHT CONTRIBUTE $100 TO A POLITICAL CAMPAIGN AND, BECAUSE THE PROHIBITION ON POLITICAL ACTIVITIES IS ABSOLUTE, MIGHT JEOPARDIZE ITS EXEMPTION. IN MANY CASES LIKE THIS, AGENTS ARE RELUCTANT TO IMPOSE THIS SANCTION.

CONVERSELY, THE SANCTION MIGHT BE UNREASONABLY LIGHT IF A PUBLIC CHARITY HAS LITTLE OR NO TAXABLE INCOME. IN MANY OF THESE CASES, THE ONLY REAL CONSEQUENCE IS LOSS OF DEDUCTIBLE CONTRIBUTIONS. IF A PUBLIC CHARITY IS TREATED AS A TAXABLE ORGANIZATION AFTER REVOCATION OF EXEMPTION, LOSS OF EXEMPTION IS NOT PARTICULARLY PUNITIVE IN TERMS OF THE COST IN TAX DOLLARS. THERE IS NO TAX COST TO A PUBLIC CHARITY WHICH COULD QUALIFY UNDER SECTION 501(C)(4) DURING THE SAME PERIOD.

SECTION 501(C)(3) PROHIBITS ATTEMPTS TO INFLUENCE LEGISLATION IF THEY ARE A SUBSTANTIAL PART OF AN ORGANIZATION'S ACTIVITIES. IF AN ORGANIZATION DOES NOT ELECT SECTION 501(H) TREATMENT OR IF AN ORGANIZATION IS PRECLUDED FROM ELECTING THIS TREATMENT, THE ONLY SANCTION UNDER SECTION 501(C)(3) IS LOSS OF EXEMPTION. PRIVATE FOUNDATIONS, ALTHOUGH THEY ARE NOT ELIGIBLE FOR THE SECTION 501(H) ELECTION, ARE SUBJECT TO THE EXCISE TAX UNDER SECTION 4945 IF THEY ENGAGE IN ATTEMPTS TO INFLUENCE LEGISLATION.

LOSS OF EXEMPTION IS A CUMBERSOME SANCTION FOR ORGANIZATIONS ENGAGED IN ATTEMPTS TO INFLUENCE LEGISLATION FOR MANY OF THE SAME REASONS THAT IT IS CUMBERSOME FOR ORGANIZATIONS INVOLVED IN POLITICAL ACTIVITIES. IN ADDITION, HOWEVER, THERE IS THE DIFFICULTY OF MEASURING THE "SUBSTANTIALITY" OF THESE ACTIVITIES. LACK OF A PRECISE STANDARD CAUSES PROBLEMS FOR THE SERVICE IN ITS ATTEMPT TO ENFORCE THE STATUTE UNIFORMLY. IT ALSO HAS A NEGATIVE EFFECT ON CHARITABLE ORGANIZATIONS SINCE THEY CANNOT GAUGE THE PERMISSIBLE LEVEL OF THESE ACTIVITIES.

II. EXEMPT ORGANIZATIONS ENFORCEMENT PROGRAM

LET ME DESCRIBE TO THE COMMITTEE THE SERVICE'S EXAMINATION PROGRAM IN THIS AREA.

THE SERVICE SELECTS EXEMPT ORGANIZATION RETURNS FOR EXAMINATION FROM FOUR INDEPENDENT SOURCES.

MOST RETURNS ARE SELECTED BASED ON A COMPUTER SCORING SYSTEM SIMILAR IN APPROACH TO THAT USED FOR SCORING INCOME TAX RETURNS. THIS COMPUTER SCORING SYSTEM IS BASED ON INFORMATION FURNISHED ON THE ANNUAL RETURN AND IS INTENDED TO IDENTIFY THOSE RETURNS MOST IN NEED OF EXAMINATION.

A SECOND SELECTION CATEGORY IS THE TAXPAYER COMPLIANCE MEASUREMENT PROGRAM (TCMP) FOR EXEMPT ORGANIZATION RETURNS. THIS ALSO PARALLELS OUR INCOME TAX APPROACH, AND IS A SCIENTIFICALLY DESIGNED RANDOM SAMPLE OF RETURNS THAT ARE AUDITED IN DETAIL. THE RESULTS OF THE TCMP EXAMINATIONS FORM THE BASIS OF THE COMPUTER SCORING

MENTIONED ABOVE. THE TCMP PROGRAM IS DESIGNED TO ASSIST THE SERVICE IN IDENTIFYING THE OVERALL LEVEL OF COMPLIANCE BY TAX EXEMPT ORGANIZATIONS AND TO ASSIST THE SERVICE IN DETERMINING HOW TO ALLOCATE STAFF RESOURCES. THE MOST RECENT TCMP EXAMINATIONS IN THE EXEMPT ORGANIZATION AREA WERE CONDUCTED BETWEEN 1980 AND 1985, AND THEIR RESULTS WERE INCORPORATED IN COMPUTER SCORING PERFORMED AFTER JANUARY 1, 1986.

A THIRD SOURCE OF EXAMINATIONS IN THE EXEMPT ORGANIZATION AREA IS BASED ON INPUT FROM THE PUBLIC. AS IN THE INCOME TAX AREA, THE SERVICE RECEIVES INFORMATION FROM A MULTITUDE OF SOURCES, INCLUDING THE MEDIA, THE CONGRESS, AND THE GENERAL PUBLIC, SUGGESTING THAT A PARTICULAR ORGANIZATION MAY BE CARRYING ON NONEXEMPT ACTIVITY.

INFORMATION OF THIS SORT IS USED BY OUR DISTRICT OFFICES, WHICH EVALUATE THE INFORMATION AND DECIDE WHETHER AN EXAMINATION IS WARRANTED. THE DECENTRALIZATION OF RESPONSIBILITY FOR MAKING DECISIONS ON WHETHER TO CONDUCT AN EXAMINATION WITH RESPECT TO INFORMATION OF THIS SORT IS INTENTIONAL. IT IS DESIGNED TO MINIMIZE POLITICAL INFLUENCE, AND IS A POLICY OF LONGSTANDING DURATION THAT WAS FORMULATED WHEN THE SERVICE WAS REORGANIZED IN THE EARLY 1950'S.

THE FOURTH SOURCE OF EXAMINATIONS IN THE EXEMPT ORGANIZATION AREA IS SPECIAL EMPHASIS PROGRAMS. AT VARIOUS TIMES, SPECIAL EMPHASIS IS PLACED ON A PARTICULAR AREA WHERE THERE ARE INDICATIONS OF POSSIBLE NONCOMPLIANCE. FOR EXAMPLE, A GREATER CONCENTRATION OF RESOURCES HAS BEEN USED IN PAST YEARS TO EXAMINE PRIVATE FOUNDATIONS, PRIVATE SCHOOLS, GRASSROOTS LOBBYING ACTIVITY, AND (CURRENTLY) ADMINISTRATIVE EXPENSES OF PRIVATE FOUNDATIONS.

OUR EXPERIENCE IS THAT PRESS ACCOUNTS AND INQUIRIES FROM THE GENERAL PUBLIC AND THE CONGRESS PROVIDE, AT PRESENT, THE BEST SOURCES OF INFORMATION REGARDING POSSIBLE NONCOMPLIANCE IN THE POLITICAL AND LOBBYING ACTIVITIES AREA. IN ADDITION, WE ARE PRESENTLY CONSIDERING THE ADVISABILITY OF ESTABLISHING A SPECIAL EMPHASIS PROGRAM. AS THE HOLDING OF THIS HEARING ATTESTS, THERE IS CONSIDERABLE DEBATE AS TO THE EXTENT OF QUESTIONABLE POLITICAL AND LOBBYING ACTIVITY. AND WHILE I CAN ASSURE THIS COMMITTEE THAT THE SERVICE'S EXAMINATION PROGRAM IN THIS AREA IS AN ACTIVE ONE, IT APPEARS THAT A SPECIAL EMPHASIS PROGRAM OF THE SORT WE HAVE CONDUCTED IN THE PAST, COULD BE AN APPROPRIATE MEANS TO DETERMINE THE EXTENT OF THE PROBLEM IN THIS AREA.

WE BELIEVE THAT EXISTING IRS STAFFING IS ADEQUATE TO MONITOR AND ENFORCE THE PRESENT LAW RESTRICTIONS ON LOBBYING AND POLITICAL ACTIVITIES APPLICABLE TO TAX-EXEMPT ORGANIZATIONS. CURRENTLY, WE CONDUCT APPROXIMATELY 20,000 EXAMINATIONS ANNUALLY AND HAVE A STAFF OF APPROXIMATELY 300 EXAMINERS.

III. SUMMARY AND CONCLUSION

THE CONGRESSIONAL RESPONSES IN 1969 RELATING TO PRIVATE FOUNDATIONS AND IN 1976 TO PUBLIC CHARITY LOBBYING CLEARLY REFLECTED A RECOGNITION OF THE DIFFICULTIES IN INTERPRETING AND ENFORCING THE TAX LAWS RELATING TO LOBBYING AND POLITICAL ACTIVITY BY TAX-EXEMPT ORGANIZATIONS. OTHER GROUPS, SUCH AS THE FILER

COMMISSION, MADE SIMILAR OBSERVATIONS. WHILE THE 1969 AND 1976 LAW CHANGES ARE INDEED SALUTARY, THE FUNDAMENTAL PROBLEMS REGARDING RESTRICTIONS ON LEGISLATIVE ACTIVITIES CONTINUE TO REMAIN FOR PUBLIC CHARITIES OUTSIDE OF THOSE ELECTING UNDER SECTION 501(H), AND THE FUNDAMENTAL PROBLEMS REGARDING RESTRICTIONS ON POLITICAL ACTIVITY FOR ALL PUBLIC CHARITIES ARE THE SAME AS THEY HAVE BEEN AT LEAST FOR THE LAST THIRTY-THREE YEARS. UNLIKE GOOD WINE, THE SUBSTANCE HAS NOT IMPROVED WITH AGE.

OVER THE YEARS, THE AREA OF LOBBYING AND POLITICAL ACTIVITY BY TAX-EXEMPT ORGANIZATIONS HAS BEEN A HIGHLY SENSITIVE ONE THAT IS A SEEDBED FOR TAXPAYER CONTROVERSY. UNDER CURRENT LAW THE POTENTIAL FOR TAX ABUSE EXISTS, AND THERE IS LITTLE RISK OF PENALTY ON THE ORGANIZATION, ITS MANAGERS, AND ITS CONTRIBUTORS FOR MANY TYPES OF VIOLATIONS.

THE SUBSTANCE AND MECHANICS OF THE 1976 TAX LAW CHANGES FOR LOBBYING BY PUBLIC CHARITIES ARE BASICALLY SOUND. HOWEVER, ITS ELECTIVE NATURE PERPETUATES OLD PROBLEMS, LEAVING THE SERVICE WITH TWO SETS OF RULES IN PLACE. THIS DICHOTOMY ADVERSELY AFFECTS OUR ABILITY TO ADMINISTER THE LAW EVEN-HANDEDLY. AT THE SAME TIME, TAX LAW CHANGES MADE IN 1969 AFFECTING PRIVATE FOUNDATIONS CONTINUE TO WORK WELL.

WITH YOUR ASSISTANCE AND THE FULL COOPERATION OF THE SERVICE AND TREASURY, I AM HOPEFUL THAT TOGETHER WE CAN IMPROVE UPON THE CLARITY OF SOME FUNDAMENTAL RULES IN THIS AREA THAT WILL THUS BENEFIT THE AFFECTED ORGANIZATIONS. AT THE SAME TIME, I HOPE WE CAN MAKE THE PROBLEMS OF ADMINISTRATION MORE MANAGEABLE FOR THE SERVICE IN THE FUTURE.

IV. EXHIBITS/CHARTS

A. GENERAL SUMMARY OF RULES RELATING TO POLITICAL ACTIVITIES OF TAX EXEMPT ORGANIZATIONS UNDER THE INTERNAL REVENUE CODE

B. GENERAL SUMMARY OF RULES RELATING TO LEGISLATIVE ACTIVITIES OF TAX EXEMPT ORGANIZATIONS UNDER THE INTERNAL REVENUE CODE

Exhibit A

GENERAL SUMMARY OF RULES RELATING TO
POLITICAL ACTIVITIES OF TAX EXEMPT ORGANIZATIONS UNDER THE
INTERNAL REVENUE CODE

	Organizations Described in IRC 501(c)(3) which do not elect under 501(h)	Organizations Described in IRC 501(c)(3) which elect under 501(h)	Organizations Described in IRC 501(c)(3) - Private Foundations	Organizations Described in IRC 501(c)(4) - Social Welfare Organizations	Organizations Described in IRC 501(c)(5) (Unions) or 501(c)(6) (Trade Assoc.)	Political Organizations	
						Independent Entity	Separate Segregated Funds
Applicable Statutory & Reg. Citation	26 U.S.C. 501(c)(3) TREAS. REG. 1.501(c)(3)-1(c)(3)(iii)	26 U.S.C. 501(c)(3) TREAS. REG. 1.501(c)(3)-1(c)(3)(iii)	26 U.S.C. 501(c)(3) 26 U.S.C. 4945(d)(2) TREAS. REG. 1.501(c)(3)-1(c)(3)(iii)	26 U.S.C. 501(c)(4) Treas. Reg. 1.501(c)(4)-1(a)(ii) 26 U.S.C. 527	26 U.S.C. 501(c)(5) 26 U.S.C. 501(c)(6) 26 U.S.C. 527	26 U.S.C. 527	26 U.S.C. 527(f) TREAS. REG. 1.527-2(h)
General Restrictions on Activities Under Internal Revenue Code	Complete ban on direct or indirect participation in a campaign for public office.	Same ban applies as with other 501(c)(3) entities.	Same ban applies as with other 501(c)(3) organizations. Also political expenditures are taxed under 4945(d)(2).	Political activity is not considered promoting social welfare. Organization can engage in such activity so long as its primary activity is promoting social welfare.	No express statutory or regulatory limitation on such activity. Generally, however, political activity may not be the primary activity for these organizations.	No limitation on political activity.	No limitation on political activity. 501(c)(3) organizations may not set up these funds.
Deductibility of Dues/Contributions to Entity by Donors/Members	Yes--as charitable contribution (up to 50% AGI), so long as general restrictions above are met.	Same as other 501(C)(3) entities.	Yes-As charitable contribution up to 30% AGI.	Not eligible for charitable contribution treatment as business expense. See discussion of 501(c)(5) and (c)(6).	Dues are business expenses, except that, if organization has substantial political or grassroots lobbying activity, that portion of dues is nondeductible. See 1.162-20(c)(3).	Generally no, pre-Tax Reform Reform Act of 1986 tax credit for individuals ($50/$100).	Nondeductible. Member dues diverted from general treasury are nondeductible.
Taxes/Sanctions Imposed on Entity	Revocation if found to have violated ban on political activity. Political expenditures possibly subject to tax under 26 U.S.C. 527(f). Reported on Form 1120 POL.	Same as other 501(c)(3) entities.	An exise tax is imposed if the organization seeks to influence the outcome of any election or makes an earmarked grant. Otherwise the same as other 501(c)(3). Special rules for nonpartisan voter registration activity. (see 4945(f)).	Section 527 imposes a tax on political expenditures to the extent of investment income. Revocation if organization found to engage in such activity as its primary activity.	Same as 501(c)(4).	In general, a nontaxable entity except that investment income is subject to to taxation. Income from "non-exempt" activities may be taxed.	501(c) organization pays taxes on fund's investment income.
Disclosure of Activity on Application for Status	Yes—See Form 1023, Part III, Q 11.	Same as other 501(c)(3) entities.	Yes-See Form 1023, Part III, Q 11.	Yes-Form 1024, Part III, Q 17 and Form 1024, Schedule A, Q 1.	Yes--Form 1024, Part III, Q 17.	There is no application for status.	There is no application for status.
Continuing Requirements for Disclosure of Activities	Yes—See Form 990, Part VII, Q 81. Form 1120 POL.	Same as other 501(c)(3) entities.	Yes—1. See Form 990 PF Part VII, Q 1 2. Form 4720 (excise tax) 3. Form 1120 POL.	Yes—See, 1. Form 990, Q 81. 2. Form 1120 POL.	Yes--See 1. Form 990, Q 81. 2. Form 1120 POL.	Yes--See Form 1120-POL.	Yes--In addition to regular 501(c) filing requirements, entity must file a Form 1120 POL.
Public Disclosure of Donors/Contributors	No	Same as other 501(c)(3) entities.	Yes, if contributor gives $5000 or more. See Form 990 PF, Part I, Q 1.	No	No	No, but see CFR 104.3(a)(4) as to FEC regs.	No, but see 11 CFR 104.3(a)(4) as to FEC regs.
Limitations on Voter Registration Drives	Entity can carry on nonpartisan drive, Subject to facts and circumstances as to whether it is partisan.	Same as other 501(c)(3) entities.	Considered a taxable expenditure unless drive meets 4945(f) exception as nonpartisan drive and covers five state areas.	Nonpartisan voter registration permitted. If partisan then expenditures are subject to 527 tax.	Cannot be organization's primary activity. If partisan, and made to general public then subject to 527 tax. Partisan voter registration activities not taxable if made to members.	No limitations so long as primary activity is political.	No limitations, so long as primary activity is political.

Exhibit B

GENERAL SUMMARY OF RULES RELATING TO
LEGISLATIVE ACTIVITIES OF TAX EXEMPT ORGANIZATIONS UNDER THE
INTERNAL REVENUE CODE

	Organizations Described in IRC 501(c)(3) which do not elect under 501(h)	Organizations Described in IRC 501(c)(3) which elect under 501(h)	Organizations Described in IRC 501(c)(3) - Private Foundations	Organizations Described in IRC 501(c)(4) - Social Welfare Organizations	Organizations Described in IRC 501(c)(5) (Unions) or 501(c)(6) (Trade Assoc.)	Political Organizations	
						Independent Entity	Separate Segregated Funds
Applicable Statutory & Reg. Citation	26 U.S.C. 501(c)(3) TREAS. REG. 1.501(c)(3)-1(c)(3)(ii)	26 U.S.C. 501(h) 26 U.S.C. 4911	26 U.S.C. 501(c)(3) 26 U.S.C. 4945(d)(1) TREAS. REG. 1.501(c)(3)-1(c)(3)(ii)	26 U.S.C. 501(c)(4)	26 U.S.C. 501(c)(5) 26 U.S.C. 501(c)(6)	26 U.S.C. 527	26 U.S.C. 527(f) TREAS. REG. 1.527-2(
General Restrictions on Activities Under Internal Revenue Code	No Substantial Part of organization's activities can be carrying on propaganda or otherwise attempting to influence legislation.	Same as other 501(c)(3) organizations except organization has elected to have certain safe harbor sliding scale of "lobbying non-taxable amounts" apply. Code deems amounts within such percentages as not endangering status. 501(h) election is not available to churches, operating foundations or private foundations.	An excise tax is imposed on expenditures where the organization seeks to influence legislation. Grants to public charities earmarked for legislative activities are subject to tax. Otherwise treated the same as with 501(c)(3) non-election.	No limitation on the amount of such activity so long as the organization is attempting to influence legislation that is germane to its exempt purposes.	Same as 501(c)(4)	May do some legislative activity as long as entity is organized and operated primarily for purpose of performing political activity, inter alia, supporting candidates for public office.	Certain 501(c) organizations may set up such funds to carry on political activity. Such activities will not be attributed to the organization since the fund will be treated as an "independent entity." May do some legislative work.
Deductibility of Dues/ Contributions to Entity by Donors/ Members	Yes—as charitable contribution (up to 50% AGI), so long as general restrictions above are met. 1.170A-1(h)(5)(i).	Same as "501(c)(3) non electing."	In general as a charitable contribution up to 30% AGI.	Not eligible for charitable contribution treatment. Possible treatment as business expense. See discussion of 501(c)(5) and (c)(6).	Dues are business expenses except that if organization has substantial political or grassroots lobbying activity, portion of dues is nondeductible. See 1.162-20(c)(3).	Generally no, pre-Tax Reform Act of 1986 tax credit for individuals ($50/$100).	Nondeductible. Member dues diverted from general treasury are nondeductible.
Taxes/ Sanctions Imposed on Entity	Revocation of status if organization is found to have carried on prohibited activity in more than insubstantial amount. Permanent bar on becoming a 501(c)(4) entity under 504.	Expenditures in excess of safe harbor amounts are subject to 25% excise tax. Revocation occurs if expenditures exceed 150% of limits on a "four year forward moving average." If revoked then permanent bar on becoming a 501(c)(4) entity under 504.	A first-tier tax of 10% is imposed on lobbying expenditures that are not covered by an exception. A second-tier tax of 100% is imposed if the taxable expenditure is not corrected. A tax may be imposed on management.	None	None	In general, a nontaxable entity except that investment income is subject to taxation. Income for "non-exempt" activities may be taxed.	501(c) organization pays taxes on "fund" investment income.
Disclosure of Activity on Application for Status	Yes--See Form 1023, Part III, Q 11.	Yes—See Form 1323, Part III, Q11. Form 5768 is used to elect or revoke under 501(h).	Yes--See Form 1023, Part III, Q 11.	None-Except in statement of general activities on Form 1024.	Same as 501(c)(4).	There is no application to for status.	There is no application for status.
Continuing Requirements for Disclosure of Activities	Yes--See Form 990 Schedule A, Part III, Q 1.	Yes—1. Form 990 Schedule A, Part III, Q 1 and Part VI. 2. Form 4720 to report excess lobbying expenses, if any.	Yes--1. See Form 990 PF Part VII, Q 1. 2. Form 4720 as to excise tax.	None	Yes—Form 990, Q 83 with regard to grassroots lobbying.	Yes--See Form 1120-Pol.	Yes—in addition to regular 501(c) filing required entity must file a Form 1120 Pol.
Public Disclosure of Donors/ Contributors	No	No	Yes, if contributor gives $5000 or more. See Form 990 PF, Part I, Q 1.	No	No	No, but see 11 CFR 104.3(a)(4) as to FEC requirements.	No, but see 11 CFR 104.3(a)(4) as to FEC requirements.

Chairman **Pickle**. Thank you, Commissioner, and both your statement and, Secretary Mentz, your statements will appear in the record in their entirety, because I know that the public will want to have a chance to study your comments.

Now, Mr. Secretary, you stated that you think that rather than recommending wholesale changes, you have modifications and recommendations in certain areas.

And, Commissioner Gibbs, you've said that under the current law, the potential for tax abuse does exist, and you also state that you need clearer guidance to specify the limits of permissible activities, but that it would be administratively difficult to achieve.

I take it both of you are saying that while you're not recommending wholesale changes, that certain things ought to be considered by this committee with reference to your particular recommendations.

Now I'm going to ask a series of questions prepared by the staff, and I don't expect you to go into detail. We don't have time for that, but you might want to respond to us, I hope, in writing or in conversation with our committee.

But I think the question generally would be, so I will ask you: Would Treasury or IRS be willing to support certain clarifications, and let me list some of them?

One, would you require an affirmative statement on literature indicating whether the contributions are or are not tax-deductible? That is, is a contribution deductible or is it not deductible?

Specifically, would you recommend in their publications or their literature that they have a statement in clear, bold, noticeable type and placed in a proper spot on the literature, saying that it was or was not tax-deductible? Is that desirable?

Mr. **Mentz**. I don't find any problem with that, Mr. Chairman and I wouldn't object to it. I don't think it will reach any of the more fundamental problems that we've been talking about. But as a matter of policy, I don't see a problem with doing it.

Chairman **Pickle**. Mr. Gibbs.

Mr. **Gibbs**. Nor do I, Mr. Chairman.

Chairman **Pickle**. No, what?

Mr. **Gibbs**. I do not see any problem with doing that.

Chairman **Pickle**. Well, yesterday or the day before, I noticed one of the organizations, the so-called Roosevelt group, put out a mailing, and the envelope clearly says the organization is 501(c)(3), and on the back, when you flip the envelope, it says it's 501(c)(3). But down at the bottom underneath your signature in print that I could hardly read, even with my glasses, it says also this was a 501(c)(4) organization and so forth.

Now I don't know where that money was really going. I assume it was going to the (c)(3), and it's transferred over to the (c)(4).

Somehow or another, it ought to be clearly observed by the public that this is or is not tax-deductible. So I would appreciate your opinion on this.

Second, what about providing an Internal Revenue Code sanction, revocation, or a penalty tax, on an organization that claimed it is eligible for tax-deductible contributions when it's not eligible for them?

I understand what you said, Mr. Mentz, that you think we ought to have something short of revocation in the area of sanctions. Is that correct?

Mr. MENTZ. I was talking about a sanction in addition to revocation of the exemption, where the exemption really isn't that significant.

You are addressing a different point. You're saying an organization fraudulently purports to be eligible for tax-deductible contributions.

I think that's probably already subject to Internal Revenue Code sanctions.

Chairman PICKLE. Well, have you exercised any of those sanctions?

When an organization says a contribution is tax-deductible, and it's not tax-deductible, what do you do about? Have you taken action on them?

Mr. MENTZ. Larry, do you know?

Chairman PICKLE. Well, I guess Mr. Gibbs.

Mr. GIBBS. Clearly, when that happens, the penalty will fall on the donors. If it's not an exempt organization, then no matter what——

Chairman PICKLE. Have you exercised a penalty or sanction against any organizations who have claimed this?

Mr. GIBBS. Let me ask. Just a second.

[Witness Gibbs conferring off the record.]

Mr. GIBBS. Mr. Chairman, I am told that when we get into this type of area, it essentially is a matter in which we have cooperated with State officials to police the general area where we have these types of improper statements being made. So I don't know that we have a penalty or sanction at the present time. Mr. Mentz mentioned one——

Chairman PICKLE. Well, it's not unreasonable to assume that you don't have a penalty or sanction, and therefore one could not have been exercised. Isn't that a fair assumption?

Mr. GIBBS. I do not know that we have one at the present time.

Mr. MENTZ. I'm just wondering whether the fraud provisions might not apply.

Mr. GIBBS. I think they would.

Chairman PICKLE. Say it again, Mr. Secretary?

Mr. MENTZ. I think that in an extreme case, Mr. Chairman, the employees, the members of the charitable organization, in soliciting what purport to be tax-deductible contributions but which they know are not, are probably engaged in civil and possibly criminal tax fraud. So I think there are those sanctions.

Now my guess is, they're not imposed very frequently.

Chairman PICKLE. Well, we have them, perhaps, on the books, but they're just not being exercised. And if you leave it up to the States, holy mackerel. There's no action there, and understandably so.

Now, would you recommend a revision of the form 990 to require more specific information on lobbying and political activity? Can we simplify that form? Can we make it more clear? Can we make the 990 more useful, because the GAO said it's really not very useful at this point?

Mr. GIBBS. I think that the GAO point was that there are other tax-exempt organizations, not charities, but certain tax-exempt organizations that can lobby with impunity. For that reason, we have not burdened them in the form 990 with requests about their lobbying activities.

Chairman PICKLE. Well, could you—would you be in favor of revising the 990 form to better identify the in-tandem organizations?

Mr. GIBBS. We have a question on the form 990 at the present time, Mr. Chairman, that does inquire about the affiliation of organizations, as has been reported here this morning. Unfortunately we do not often receive information that we need in response to those questions.

Chairman PICKLE. Does that 990 form require organizations to report other tax-exempt organizations on which their board members serve?

Mr. GIBBS. There are provisions that require reports with respect to certain types of affiliations.

Chairman PICKLE. Is that on the 990 now?

Mr. GIBBS. Yes, it is on the 990 at the present time.

Chairman PICKLE. Well, what do we need in connection with that, then? A better definition?

Mr. GIBBS. Well, I think one of the things that Mr. Mentz mentioned and that we would agree with is that a more explicit definition of "affiliation" is needed. We have one at the present time, but a more explicit one is needed with some specifically tailored sanctions.

Certainly—let me put it this way. Let's get back to some of these types of things. Mr. Dorgan asked a question a minute ago about, don't you really have sanctions at the present time that you could use.

My response to that is, yes, but the type of sanctions you have are often difficult to use, and let me give you an example.

When the form is signed, it's signed under the penalties of perjury. If someone omits information, did they do so intentionally? Can we make a case that that's a criminal offense? To try to use that type of penalty to enforce the disclosure of information is not an easy thing to do, and I think that one of the things we're suggesting, Mr. Chairman, is that we do try to come up with some more specifically tailored sanctions to put teeth in the questions and the requests for information that we make.

Chairman PICKLE. Well, Commissioner, last week on the House floor we had a debate on an organization based in Washington, which claimed that it was a religious organization, and thus not subject to filing any tax information. Therefore it has not filed any tax information just on the basis that it's a religious organization.

Now when that example comes to the IRS' attention, do you look into it? Do you examine it? Have you?

Mr. GIBBS. When any information comes to us, Mr. Chairman, about activity of this type, we will review it. If it comes to us in the national office, we will review it. We will send it to the appropriate field office. It will be assigned to an agent, and the agent will look at the information that is provided, plus any other information that we have and make a decision.

Chairman **Pickle**. I'm trying to find out the actual practice. This was in a debate on an amendment on the floor, and I'm sure your organization has noticed it and is mindful of it.

Do you wait for somebody to specifically file a complaint on it or raise the question, or do you look into it yourself?

Mr. **Gibbs**. Information can come to us in various ways. It can come to us from individuals. We can also find it ourselves. We do read newspapers. We do read other things.

Chairman **Pickle**. Well, I will refer that question to you, not because I'm prejudiced either one way or another, but I think it's a question that's typical of perhaps a lot of organizations, when they claim one thing, but it's never subject to an interpretation other than their own.

Now I'm going to not ask another question, but I want to yield to other members, because I'm sure they have questions. I may come back if we have more time. I'm going to submit a series of another five or six questions, particularly, Mr. Commissioner, about the audit division.

Do you need an audit division down there? Do you have a functioning auditing division at all? How do you know what's going on, if you don't have an active, ongoing Audit Division?

Mr. **Gibbs**. Mr. Chairman, as I mentioned in my opening statement, we not only have an audit division in the exempt organizations area, but it is very active.

Chairman **Pickle**. Is that right?

Mr. **Gibbs**. When you look at the fact that our audit coverage in the income tax area is now down around 1 percent, and in the exempt organizations area it has been at 5 percent, and frankly in many of the charitable areas, the private foundation area, it's up around 9 percent, we don't think that the problem is our lack of resources or our lack of audit activity.

Chairman **Pickle**. Well, GAO testified earlier this morning that there's a lot to be desired in the Audit Division. I'm sure you heard the testimony.

And we had read statements from organizations all over the country, the professors and experts saying that there really is no audit division. I'm glad to hear you say there is an active, ongoing audit division down there, and I want to come down sometime and see it.

Mr. **Gibbs**. Mr. Chairman, we'd be delighted to have you come down and see our audit activity in the exempt organizations area.

Chairman **Pickle**. Mr. Jacobs.

Mr. **Jacobs**. You never can tell, we may come see you sometime. Mr. Mentz, you made some reference to anonymity of contributors to charities and in some cases those anonymities might be quite rational or justified.

I take it you meant donors who take tax exemptions or tax deductions for their contributions.

Mr. **Mentz**. That's right.

Mr. **Jacobs**. I wonder if you would say for the record some example of a person who is given the privilege of a tax deduction for a charitable contribution who at the same time which is a public thing I judge to some extent toleranced by the society generally or by the law generally, would you give an example or two for the record of a legitimate reason for remaining anonymous and how you would distinguish between the legitimate reason and perhaps the less justified reason without any statutory requirement that disclosure be made.

Mr. **Mentz**. Well, I think that the second part of your question goes to the difficulty in the suggestion that perhaps this area should be tackled by getting at the donor.

It is very hard to tell which organizations are the bad guys that are masquerading as 501(c)(3) organizations when they are really political or lobbying organizations.

It is a very small fraction of the total tax-exempt organizations that are in that category and I think to go after every donor to every charitable institution involves the problem of abandoning privacy for the donors—for all donors—to get at what is a very small part of the problem.

I think it is a legitimate issue of privacy for any number of donors who give to a university, a church, a museum. If you look at perhaps your university, I know sometimes mine, they would put out a booklet of contributions or contributions in excess of a thousand dollars or whatever, and you will see a number of anonymous donors in there, sometimes even involving fairly large gifts.

Now in those cases, it is very unlikely that the contribution is in some way contrary to law but for his own purposes, the donor wants to be anonymous. I think we should respect that.

Mr. **Jacobs**. I assume that in a case of probable cause and there are already examples of it in the law now, probable cause of criminal investigation, the records would be available anyway, wouldn't they?

Mr. **Mentz**. The taxpayer's return is always available.

Mr. **Jacobs**. Yes.

Mr. **Mentz**. It is available to the IRS. It is not available publicly.

Mr. **Jacobs**. I am talking about in a criminal proceeding, there are some statutes on the book now, are there not, that make such returns available to the tribunal?

Mr. **Mentz**. Sure. They would be available to a tribunal. It wouldn't even have to be a criminal case if the taxpayer were litigating his tax deduction, he would have to come out and say, "Look, I gave to Yale University."

Mr. **Jacobs**. Thank you very much.

Mr. **Anthony** [presiding]. Thank you, Mr. Jacobs. Mr. Gibbs, if a tax-exempt organization purchased a helicopter, would this routinely be reported to the IRS or if a gift of a helicopter was made to a tax-exempt organization, would that routinely be made or reported to the IRS?

Mr. **Gibbs**. Mr. Chairman, I wonder if we could discuss something? I will be glad to try to be as constructive as I can, however, when we start into issues that are similar to issues that are appearing in the newspaper on a daily basis, I have a little bit of a problem. I would like to share it with you and then see how constructive I can be in trying to respond to your questions.

Mr. **Anthony**. You can respond in any way you want to.

Mr. **Gibbs**. With the fact that we do conduct some 20,000 examinations, with the fact that we get information from a variety of sources in doing that on an annual basis, and with the fact that the organization that I represent has many examinations in progress; I am concerned about responding to hypothetical questions.

If I begin responding to hypotheticals that involve facts that are prominent, I am concerned that I may impede, interrupt, perhaps embarrass the investigations that are ongoing at the present time. I base that on the fact that increasingly organizations under investigation are using the disclosure provisions as an offensive tool to file suits against the Internal Revenue Service where that discussion has taken place to try to impede the investigations and so forth that are presently underway.

Mr. ANTHONY. Well, educate me. Are you, in fact, investigating a case where a helicopter was involved?

Mr. GIBBS. I cannot answer that question because of the disclosure laws and if I attempt to do so directly or through the hypothetical, I not only subject myself to potential civil and criminal liability but more importantly, I also impede an investigation if one is being undertaken and the individuals that are being investigated wish to use that to attempt to, as I say, block or impede the investigation that we have.

Mr. ANTHONY. I have no quarrel with that at the moment because I know you are not going to answer the question and you have given the answer that you are going to stand by, but it also points out the problem that I think may exist from the opening paragraph that you gave.

In other words, you state that of your 20,000 exempt organization returns that were audited in 1986 which you say it is a 5-percent audit coverage, that you selected them through a computer scoring system.

What bothers me about that, Mr. Commissioner, is that it takes away management's ability to use management's thinking power and discretion. If you just strictly leave it up to a mechanical mode, then it appears to me that you have a great ability to have a lot of these type situations fall through the cracks, so the response that you gave me didn't really bother me because I am not aware of any case that is out there. That is the reason I asked the question.

I have not read the article so I was trying to become educated on it. But it does point up the fact that there may be a management problem and I would just ask you to take a look at that.

Mr. GIBBS. Could I comment on that?

Mr. ANTHONY. Surely.

Mr. GIBBS. Our computer scoring and our TCMP really are only part of the way as I mentioned in my opening statement as to how we begin to examine, how we are alerted to examine returns.

As I also mentioned, a third way in which we begin examinations is through information that comes to us from a variety of sources and let me assure you——

Mr. ANTHONY. And if there were a case involving a helicopter, this would probably come to you through some private source?

Mr. GIBBS. It would be in that type of thing or it might come up with respect to a scoring.

Mr. ANTHONY. Let me take a quick look at the numbers and see if my calculations are correct. Of the 20,000 returns audited last year, the lobbying and/or political activity area was only 432, only 2 percent of the total audited. The Secretary has made some strong recommendations which tells me that he acknowledges there is probably more of a problem there. Of the 432, 2 percent, you revoked 25 and you modified 24. That is 10 percent of 2 percent. That tells me that you have a serious problem out there.

Mr. GIBBS. I guess the other statistic that I would throw in there is the statistic that the GAO gave us. From the information available, it appears that only 1 percent of all of these organizations indicate that they are doing lobbying of any type.

So when you come to that and assume that the bulk of the people that are doing the lobbying and that are doing it the right way, I don't think those statistics really appear that much out of line.

Mr. ANTHONY. So, only 1 percent are reporting that they are doing any lobbying or political activity. It looks to me like the universe of what Chairman Pickle was asking you to take a stronger look at—with the audit.

I am worried about the public perception as much as the real problem. There is a growing public perception that charitable organizations are being given special favor in the Tax Code by being tax exempt, donations being tax deductible, and involving themselves in some very questionable activities.

You heard the lawyer on the previous panel who, in his judgment, has already said that one of the ads that he saw very quickly was questionable in his opinion. Would you have the ability, if you saw that type of advertisement on the television, do you have the apparatus in place so that you can immediately get that illegal activity off of the television? Can you have an audit immediately instituted so that no real harm then comes to the person that was intended to be affected by the advertisement?

Mr. GIBBS. Quite often, Mr. Anthony, when those types of things do come to our attention, we will actually contact the organization. If it is a political type of activity where they risk losing their exemption over an act, one act——

Mr. ANTHONY. You see, they risk losing their exemption and the target of their rage risks losing their job. This is a fairly serious repercussion for a tax-exempt organization and I think that is the reason there is such great sensitivity to it. That is also the reason you have this room full of visitors today. I can always tell when we are on a good issue by the size of the audience.

Mr. GIBBS. Let me also mention in response to your questions another program that we have. I said that we have four audit programs. One of the programs, the last one I mentioned, was a special emphasis program where we take a look at specific areas that are of concern, concern to the Congress, concern to the public. Quite honestly, one of the things that we are looking at currently is whether we need a special emphasis program in the lobbying and political activity area.

Mr. ANTHONY. Have you had any discussions internally or as a result of preparation for this particular hearing, do you have any feel as to whether or not tax-exempt organizations are being used to circumvent the Federal Election Campaign Act restrictions?

Mr. GIBBS. With the information that we presently have available, we do not find any widespread aspect of that. I know of none. None has come to my attention in that regard.

Mr. **Anthony**. So, therefore, no conflicts have come to your attention that maybe some of this activity could fall in between two separate statutory restrictions?

Mr. **Gibbs**. Mr. Anthony, as Mr. Mentz mentioned, we are concerned about the affiliation aspect. The charitable organization with the social welfare organization with the political action committee all tied together through common control, that is something we are concerned about.

We are hearing anecdotal evidence that that is increasing. One of the reasons why we are considering a special emphasis program is to attempt to see if we can get more information about——

Mr. **Anthony**. Well, my time has expired but let me just close by making this statement. If it is on the increase, there will be more activity in 1988 than in 1987. If you are concerned about it, then you should put in place a mechanism to monitor it in 1988 because you know it will be there.

So if we have another hearing in 1989 and if the testimony reflects in fact it was increasing and it was used in 1988 and you put no mechanism in place to monitor it, I would say that that is a failure to manage.

You know that the activity will be in 1988 the closer any primary or general election comes, so if you are concerned, I challenge you to respond internally through your management. You have done an outstanding job since you have been there and I know you have the capability of doing it and working with the secretary to do it.

So I would just challenge you to put those audit mechanisms in place early so that we can make sure that it is going to be carefully monitored.

Chairman **Pickle**. Mr. Dorgan.

Mr. **Dorgan**. Thank you, Mr. Chairman. First, Mr. Gibbs, let me say that I think that you have had a good start as Commissioner of the IRS. We have had some rocky times in past years and I just want to say that I know that it is not an easy place to run. In my judgment, you have done a good job in this short period.

Let me also say that I don't think these hearings ought to tarnish tax exempt organizations or the reputation of nonprofit tax exempts in this country. My guess is that the wide majority of them have their tax exempt status legitimately and are nonprofit, tax-exempt organizations operating well within the law and we ought not lose sight of that even as we track some of the abuses.

Now having said that, I am confused a little bit about what you say, Commissioner Gibbs, happens at the IRS with respect to this area. The GAO said that the IRS does not have a separate compliance program to monitor the lobbying and political activities of tax-exempt organizations.

Then it goes on to say the IRS examined 20,000 or about 5 percent of tax exempt organizations returns. You used the term audit when you talked about your dealing with these organizations. The GAO uses the term examined. There is a substantial difference. Which is accurate here?

Mr. **Gibbs**. Mr. Dorgan, I think they are synonymous. We use audit and examine interchangeably.

Mr. **Dorgan**. All right. If you are using the term interchangeably, does that mean that you did 20,000 full-blown, full-dress audits as opposed to office examinations using the computer?

Mr. **Gibbs**. We did 20,000 full-blown examinations, a combination of field audits and in-office audits.

Mr. **Dorgan**. In the 20,000 full-blown examinations, you found about 400 or so, two-tenths of 1 percent, that had questions about lobbying or political activity?

Mr. **Gibbs**. I think that 400 or so would be correct. I believe it was about 2 percent.

Mr. **Dorgan**. Let me ask, as someone who has been involved in tax law enforcement, I watch the newspapers and read what is going on and over the last several years, I have read allegations of substantial abuse. I know you are not in a position here today to be able to respond to specifics.

But here is a lengthy story that I happened to read when it came out about an organization that shall remain unnamed, the Freedom Council, that according to a number of publications was involved in substantial activity in the Michigan Presidential aspirations of someone.

This issue was digested over and over again and I thought to myself, if these kinds of abuses are going on, I hope somebody is looking into it. You see on television some woman down south someplace who says, "Yes, I donated money for a helicopter to the Contra soldiers through this tax-exempt organization." So you think to yourself, I hope somebody is looking into that. I hope we have a program here.

This morning, the chairman read the text of commercials that appeared on the air that apparently were paid for by a tax-exempt organization and the point is, this is proliferating. This isn't a small problem these days. In my judgment, those who are inclined to find the fringe are creating quite a problem for us in tax law enforcement.

The GAO says you do not have a separate compliance program to monitor that sort of thing. Should you have a separate compliance program? Are you going to have a separate compliance program? Do you consider this the same kind of problem that I see it?

Mr. **Gibbs**. Mr. Dorgan, let me clarify, I think, what GAO is saying. When our agents examine those 20,000 returns, which are on the form 990 and related returns, every time we do so, part of our audit technique, our examination technique, is to take a look at the existence of political or lobbying activity. So when they say we don't have a separate examination program, they meant that the political and lobbying activity is only one part of our overall exempt organization examining program. But it is certainly an important part of the program and as our agents go in and examine returns, one of the things that they will be looking for will be any evidence of inappropriate political or lobbying activity.

Mr. **Dorgan**. Based upon all of the information that is going around these days, and especially the newspaper reporters, who have done an interesting job digging out some of these things—I don't know how much of it is completely accurate, and how much of it is from sources that are unconfirmed, do you think that we are seeing and hearing, that we ought to have a task force to look at this issue? Are you considering a special task force in the IRS to deal with this?

Mr. GIBBS. Well, as I mentioned a minute ago, yes, we are, because we are considering a special emphasis program in our examination area that would be a major part of the examination program.

Mr. DORGAN. And let me ask you about funding for this general area. We have had problems in recent years on funding in order to maintain the level of audits or examinations. What is the President's request with respect to this area of the IRS? Are you going to maintain level funding, increase funding, have greater capability, or less capability to audit returns in the future?

Mr. GIBBS. Mr. Dorgan, as you may know, we have substantial increases in our overall compliance area that we have asked for and that we are beginning to hear that we are likely to receive for 1987 and 1988. And we believe that with the funding that we already have and that will be coming, and with the audit programs, examination programs that we have in place, and what we can do with a special emphasis type of program, that we will have sufficient audit coverage.

Mr. DORGAN. I do not know if that precisely answers what I was asking. What is the President asking for in his budget?

Mr. GIBBS. Let me give you the budget for 1988. The budget for 1988 would put us overall, the overall budget, in excess of $5 billion. That would be an increase of over $600 million, and virtually all of that would be in the compliance area, the audit and examination area, collection, and document matching. And we think with the resources that we are asking for, plus the programs we already have in place, it would permit us to deal with this type of issue.

Chairman PICKLE. Would the gentleman yield?

Mr. DORGAN. I'd be happy to yield.

Chairman PICKLE. As I understand it, and correct me if I'm wrong, you audited approximately 2 percent of these returns. And as I understand now, your budget figures for next year show that you would audit about 1 percent; is that correct?

Mr. GIBBS. Those are individual returns, or—those are taxable individuals or taxable corporations.

Chairman PICKLE. My point is that the funds you have requested will enable you in a normal operation, to have only about a 1-percent review of these organizations, as compared with approximately 2 percent now. Is that not correct?

Mr. GIBBS. That is not correct, Mr. Pickle. The GAO testimony earlier this morning is correct; and that is, we have a 5 percent audit coverage in our exempt organization area, and in some parts of it, it goes up to almost 9 percent. So it is substantially higher in the exempt organizations area than it is overall.

Chairman PICKLE. I'm glad to get that correction. I'm going to check with my staff on it because I understood your figures were going to be less.

Mr. DORGAN. Mr. Chairman, if I might just continue with two more questions. My understanding of the budget request was a level budget request for tax-exempt organizations. Am I wrong?

Mr. GIBBS. I have also asked for the authority to transfer funds, if necessary, either for tax reform purposes or for other purposes, in order to maintain a balanced approach. I guess what I'm saying is that we really believe with the audit resources that we have in the exempt organizations area already today, plus what we are likely to be able to add, if necessary, that we would have sufficient resources to address the issues.

Mr. DORGAN. But I guess the point I was trying to make is what kind of resources are you going to have? You seem to be saying you are going to have more resources for enforcement, which I understand, because we in Congress have pushed very hard to get you to that point.

My understanding is that if you in fact transfer from somewhere else, you are taking away from desperately needed audit coverage in the individual area. We have had incredible erosion in audit coverage in individuals, so I don't want you transferring from there. I want the tax-exempt issue to stand on its own. You need more money to enforce that area, and we want to give you more money to do it. I don't want you taking money that we offer to increase the audit coverage in individuals to come back over here. So I guess the answer is that there's not an increase request for tax-exempt organizations, and the question is should there be.

Mr. GIBBS. I'll be happy, Mr. Dorgan, to review it and give you a specific answer on that. I don't believe so, but let me, in light of your concern and your questions, let me review it and give you a specific answer on it.

[The information follows:]

FY 1988 BUDGET REQUEST IMPACT ON EXAMINATION OF EXEMPT ORGANIZATIONS

For FY 1988, the Service is requesting the same level of staffing as FY 1987. We currently project that we will examine approximately 20,000 returns from exempt organizations in FY 1988, a number similar to the numbers of such examinations conducted in each of the last several years. Our budget requests 470 staff years to be divided between conducting examinations of existing exempt organizaitons and reviewing applications of organizations seeking tax exempt status. We have the ability to shift emphasis and resource utilization between these two areas as conditions warrant without impacting other compliance areas.

The breadth of our presence in examining returns filed by exempt organizations is significantly wider than that of income tax returns filed. We believe that by continuing to examine approximately 1 of every 20 exempt organizations returns filed, we will maintain sufficient enforcement presence in the area. Accordingly, we believe no staffing increase is needed.

Mr. DORGAN. And just one further question, if I might. The answer on what happens to someone who gets involved in all this sort of activity on the fringes gets heavily into political activity or lobbying activity with tax-exempt funds. Was your answer suggesting that an audit would await the filing of a form 990? Because if that were the case, somebody who goes on TV and attacks the Ortega Dozen, or whatever they do these days, is not going to worry about an audit until the 990 is filed later in the year?

Mr. GIBBS. In certain circumstances we actually contact the exempt organizations in advance of an audit. If something comes to our attention that indicates that the organization is engaging in an inappropriate type of activity, we will contact the organization simply because that has come to our attention.

Mr. DORGAN. Now I have great respect for the IRS, and want to help you get the resources to do the best job you can. The statement that press accounts and information from the Congress and the public are the best source about noncompliance scares me, frankly. With 800,000 tax-exempts, with these kinds of abuses, at least on the fringes, we need the IRS to be aggressive and vigilant in making sure that those tax-exempt contributions are not moving over here in political or lobbying activities in violation of the law.

So I hope that you don't rely on us, because we know precious little about this, except what we are reading in the newspapers and referring to you.

Chairman PICKLE. Thank you. Mr. Schulze, do you have any questions?

Mr. SCHULZE. Yes. Thank you, Mr. Chairman.

Thank you, gentlemen, for your testimony.

I'd like to get a little more specific about the form 990. I had written some time ago to the Commissioner of the Mid-Atlantic Region in regard to a breakdown in audits of 990's He replied to me that they did examine about 5 percent of the total file, which I think is a reasonable portion. But they found that about 85 percent of them reflected some type of additional action. So it says to me that you seem to be auditing sufficient numbers, but that we have got to make some changes in the form 990. Either they're not understanding it, or we're not getting the right information, or there have to be some dramatic changes. I wonder if you are ready today to give us the specifics of those changes.

When I read it, there are vague areas, and I'd like to have your specific recommendations.

Mr. GIBBS. One of the recommendations that Mr. Mentz made a minute ago was to have a more specific definition of affiliated organizations, require them to report the affiliation on the form 990, and then tailor specific sanctions if the organization fails to meet its statutory obligation.

We think that in light of the proliferation of multiple entities, charitable entities, social welfare entities, political action committees, and so forth, that are controlled and therefore oftentimes work in conjunction with one another, that would be a help to us and would directly relate to our ability to use the information on the form 990 in policing this area.

Mr. SCHULZE. Is it the position of the Service that we're going to get a greater proliferation of this type of commingling in the future, and therefore it would be important to act now? I don't want to put a chill across the charitable organizations in the country unnecessarily. With the recent tax changes, I think we've made them nervous enough, and so if it's essential, we should act in this area. If it's not essential, maybe through just changing forms and so forth, we can develop sufficient information to make those changes at a later date. I'd like to have your input on it.

Mr. GIBBS. Mr. Schulze, we share your concern. One of the reasons why Mr. Mentz and I have been very careful in terms of the types of suggestions we're making is that we do not wish to overreact to the situation. By the same token, we also wish to address concerns about some of the abuses that may or may not be there, but certainly are ones that are being raised and discussed publicly.

For that reason, I have indicated that we are considering the possibility of doing a more indepth analysis of the extent of political and lobbying activity in this area.

Now this would be a program that would be just that, it would be trying to get beyond the anecdotal evidence to see whether there is really something out there about which we should be concerned.

Mr. SCHULZE. Larry, I presume then you have not further broken down this 85 percent which needed additional action, that has not been further broken down so that we could say that 50 percent of that came in a specific area, or——

Mr. GIBBS. Your assumption is correct, Mr. Schulze.

Mr. SCHULZE. And that's actually what you are suggesting, is to go in in more depth and do that. I think that's excellent.

Roger, do you have anything to add?

Mr. MENTZ. No, I would just reiterate what Commissioner Gibbs just said—that we are mindful of what has happened in recent years legislatively, and therefore, deliberately took the approach of let's not tamper with the basic fabric of the law here. Sure, we could make changes, we could clarify a little more, and before you know it, you get another great big thick bill. But I don't think that's a good idea.

The proposals we have tried to come up with are very targeted, fairly narrow, and I think would be, I hope would be, received well.

Mr. SCHULZE. 501(c)(3)'s do have a double benefit—contributions are tax deductible, and they are not taxable to the organization. I believe most of them jealously guard that privilege. We want to make sure that that is protected, that those who are not involved with abuses are not cast in the same pale, or that their ability to secure contributions is not jeopardized by this type of action.

Mr. MENTZ. That is quite right. The administration feels very strongly about that, that we want to be very careful with any kind of legislation in this area not to infringe on the basic rights of the vast majority of public charities that are doing tremendous good for this country.

Mr. SCHULZE. Thank you.

Thank you, Mr. Chairman.

Chairman PICKLE. Mr. Gibbs and Mr. Mentz, we appreciate your testimony. I think we all know we've got a problem and need a better definition of lobbying and political activities, and a better approach to this overall question of how we audit, especially when we know we have over 800,000 of these organizations on the books, and when we know that the volume of income is in excess of over $300 billion annually. We know then there is a chance for an organization to slip by and to avoid a tax while participating in abusive practices. It's very difficult to stop. So we recognize you've got a problem.

I think you both have made some good recommendations, or at least a willingness to consider some changes, and we are looking for them. I don't know that we can expect you to be "the policeman or the watchdog" on every one of those organizations. Those of us who are affected in Congress sometimes think you ought to be more militant. It does concern me when there is a political organization, running TV ads that are obviously political, obviously lobbying, and with the 100,000 employees at IRS, or however many you've got over the country—how many do you have?

Mr. GIBBS. Right at 100,000.

Chairman PICKLE. Well, I wish I could be that accurate on a lot of my questions. But with that many people, obviously you see it. Do you do anything about it? Do you wait for somebody to come and hit you over the head and say, "Hey, did you look into that? Why don't you look into it?" Do you wait for a 990 to be filed before you ever take action? Do you wait for a specific complaint? I don't know that you can answer that. These kinds of things make us think, and the public think that once you get one of these organizations started, it is swallowed up, they are never noticed, and they can go ahead and do pretty much what they want. We ought to somehow try to find a line that they can't go beyond without discouraging those legitimate organizations who do a greater good for the American people, which if they didn't do, the Federal Government would be asked to pay for. We sure can't do that, so we should not harm these legitimate organizations, but we should have more responsibility.

We will be talking to you, and we hope you can help us try to find a better answer to this approach.

We thank you both very much for your testimony.

Mr. GIBBS. Thanks, Mr. Chairman.

Mr. MENTZ. Thank you.

Chairman PICKLE. Now our next panel will be the Chairman of the Federal Election Commission, Mr. Scott Thomas. Is Mr. Thomas with us still? Mr. Thomas, if you will have a place at the witness table, and I also understand you have with you Mr. Thomas Josefiak, who is Vice Chairman, and Mr. Charles Steele, who is general counsel. So we want you to take your position at the witness table, and as soon as our guests file out or have a seat, we will resume.

As our guests are filing out and before we start the next panel, let me inquire if the Internal Revenue Service will have people here to stay and listen to this testimony. Commissioner Gibbs, are you gone? Have all of your representatives gone? [No response.]

Secretary Mentz, have you gone and have all the other people gone with you? [No response.]

Well, I saw one hand raised by someone from the Internal Revenue Service. Who is that back there? Would you come up toward the front so we can see you because we may want to ask you a question?

Is anybody from the Treasury here? Will you also be available just in case we want to ask a question? We will ask you to identify yourself later if we need to. I want to be sure the word will go back on any statements these witnesses may make.

Our witness now is the Chairman of the Federal Election Commission, Mr. Scott Thomas.

Mr. Thomas, will you proceed, sir?

STATEMENT OF HON. SCOTT E. THOMAS, CHAIRMAN, FEDERAL ELECTION COMMISSION, ACCOMPANIED BY COMMISSIONER THOMAS J. JOSEFIAK, VICE CHAIRMAN, AND CHARLES N. STEELE, GENERAL COUNSEL

Mr. THOMAS. Mr. Chairman and members of the subcommittee, I welcome this opportunity to appear before you. As you indicated, with me today on my left is Commissioner Thomas J. Josefiak. He is the Vice Chairman of the Federal Election Commission. To my right is Charles Steele. He is our general counsel.

I have earlier submitted a written statement to the subcommittee, and I will be brief in my summation of that material.

You have asked the Commission to comment on its role in regulating and examining the political activities of tax-exempt organizations. Whether or not a particular entity enjoys tax exempt status generally does not affect Commission administrative decisions or enforcement actions. For example, the Commission monitors the broad statutory ban on corporations and labor organizations making any contribution or expenditure in connection with Federal elections. This ban applies to any corporation whatever, profit or nonprofit, taxable or tax exempt.

Thus, even though a corporation or labor organization may be tax exempt, if it makes a contribution or expenditure in connection with a Federal election, the FEC is charged with the duty to regulate this activity.

Similarly, the question of whether a group is a "political committee" which must report and register under the Federal Election Campaign Act depends in essence on whether it receives a certain amount of contributions or makes a certain amount of expenditures for the purpose of influencing Federal elections.

Now, again I would emphasize that for purposes of Federal election law, it does not matter whether a particular group is taxable or tax exempt. Let me assure the members of the subcommittee the FEC stands ready, if the facts are properly brought before it through the Commission's enforcement or advisory opinion procedures, to analyze whether a particular group or organization is, in fact, making contributions or expenditures for the purpose of influencing a Federal election, regardless of its claimed tax status.

The Commission routinely faces the question of whether particular receipts or disbursements qualify as contributions or expenditures and must make such difficult determinations using its experience and judgment——

Mr. ANTHONY [presiding]. Mr. Thomas, would you hold for just a second.

The Chair would like to ask the public to take their seats, please. The Chair would ask that people in the audience take their seats during this testimony.

Mr. THOMAS. As I was saying, we routinely face at the FEC the question of whether particular receipts or disbursements qualify as contributions or expenditures, and we must make those difficult determinations using our experience and judgment and the available legal precedent.

Now, recognizing that there are overlapping areas of concern, the FEC and the IRS have shared and will continue to share information and coordinate our respective functions to the extent feasible. With regard to the specific area of tax exempt organizations, our staff recently met with staff from the Tax Exempt Organization Branch of the IRS to discuss ways to more efficiently share information regarding enforcement within the strict confines of the confidentiality rules under which both agencies operate.

At present, we make information about our closed enforcement cases available to the IRS at the earliest possible time. In addition, we are discussing methods by which each agency can access the other agency's public records in ways that will make the most efficient and timely use of both agencies' procedures.

The Commission stands ready to provide the subcommittee with whatever information or assistance it might request. If there are any questions at this time, we will attempt to answer them.

[The prepared statement follows:]

STATEMENT OF SCOTT E. THOMAS
CHAIRMAN OF THE FEDERAL ELECTION COMMISSION

I. Introduction

Mr. Chairman and members of the Subcommittee, as Chairman of the Federal Election Commission, I welcome this opportunity to appear before you. With me are Commissioner Thomas J. Josefiak, who is the Vice Chairman of the Federal Election Commission, and Charles N. Steele, our General Counsel.

You have asked the Federal Election Commission (FEC) to comment on its role in regulating and examining the political activities of tax-exempt organizations. You also have asked for a description of the interaction between the FEC and the Internal Revenue Service with respect to FEC administrative decisions or enforcement actions that might affect the tax-exempt status of a given entity.

II. The FEC regulates "political committees."

The first, and most obvious, way in which the FEC regulates tax-exempt organizations stems from the statutory requirement that "political committees" (as defined at 2 U.S.C. §431(4)) must register and report receipts and disbursements. See 2 U.S.C. §§432, 433, and 434. Some common examples of "political committees" are the authorized committees of federal candidates, the party committees at the national, state, and local level that support federal candidates, and the political action committees of corporations, unions, and issue groups.

Whether a group or organization is a "political committee" under the Federal Election Campaign Act depends, in essence, on whether it receives a certain amount of "contributions" or makes a certain amount of "expenditures." See 2 U.S.C. §431. The latter two terms of art are themselves defined at 2 U.S.C. §431(8) and (9) and generally refer to gifts or payments made "for the purpose of influencing" a federal election.

Not only must "political committees" register and report; they are subject to limitations on the amount of contributions they may receive or make. See 2 U.S.C. §441a(a). Further, they may not accept contributions from corporations, labor organizations, foreign nationals, national banks, or government contractors. See 2 U.S.C. §§441b, 441c, and 441e.

For the most part, there is little confusion as to whether a particular group or organization is a "political committee" under federal election law. Authorized committees of candidates, political party committees, and political action committees formed by corporations, unions, and issue groups generally make clear in their organizational documents, solicitations, and their other actions that they are raising "contributions" and making "expenditures" for the purpose of influencing federal elections. There may be other groups, however, that profess not to be "political committees" and that profess to be exempt from federal taxation under §501(c), but upon close analysis really appear to be making "contributions" or "expenditures" for the purpose of influencing federal elections.

Let me assure the members of the Subcommittee, the FEC stands ready, if the facts are properly brought before it through the Commission's enforcement procedures or advisory opinion request procedures, to analyze whether a particular group or organization is in fact a "political committee," regardless of its claimed tax status. The Commission routinely faces the question of whether particular receipts or disbursements qualify as "contributions" or "expenditures" and must make such difficult determinations using its experience and judgment and the available legal precedents.

III. The FEC regulates corporations and unions that may be tax-exempt.

Apart from its authority to regulate groups that qualify as "political committees," the Commission also monitors the broad statutory ban on corporations or labor organizations making any contribution or expenditure in connection with federal elections. See 2 U.S.C. §441b. This ban applies to any corporation whatever--profit or non-profit, taxable or tax-exempt. (FEC regulations do allow political committees to incorporate for liability purposes, but such entities are regulated as political committees, not as corporations.) Thus, even though a corporation or labor organization may be tax-exempt, if it makes a contribution or expenditure in connection with a federal election, the FEC is charged with the duty to regulate such activity. There have been several occasions when the FEC has ruled on whether the actions of a corporation with tax-exempt status or a union are in contravention of 2 U.S.C. §441b. Our staff has provided your Subcommittee staff with copies of several advisory opinions issued by the Commission in this area.

It must be emphasized, however, that the FEC does not routinely examine whether a corporation or union is tax-exempt. In other words, it does not matter, for purposes of federal election law, whether a corporation is taxable or tax-exempt under §501(c)(3) or (c)(4) or whether a union is tax-exempt under §501(c)(5). As noted above, under 2 U.S.C. §441b, any corporation whatever and any labor organization falls within the general prohibition.

IV. Areas in which the federal election law differs from the tax rules.

The federal election statutes do specify several important exemptions from the general ban set out in 2 U.S.C. §441b. One exemption allows corporations and labor organizations to pay for the establishment, administration, and solicitation costs of a separate segregated political fund. See 2 U.S.C. §441b(b)(2)(C). Another exemption allows corporations and unions to make partisan communications to a restricted group of persons (stockholders and executive and administrative personnel in the case of stock corporations, members in the case of non-stock membership corporations, and members and executive and administrative personnel in the case of unions.) See 2 U.S.C. §441b(b)(2)(A); 11 C.F.R. §114.3. Further exemptions for certain non-partisan communications beyond the restricted group (e.g., ads encouraging the public to vote, publications concerning the voting records of Members of Congress, and voter guides comparing the positions of the candidates for a particular office) are set forth in the Commission's regulations at 11 C.F.R. §114.4.

There is some tension between the foregoing exemptions from 2 U.S.C. §441b which allow a tax-exempt corporation to engage in enumerated election-related activities and certain provisions of the tax law that attempt to restrict such activities. Under 26 C.F.R. §1.527-6(g), for example, it appears that a §501(c)(3) organization is precluded from establishing, administering, and soliciting contributions for a separate segregated political fund, whereas 2 U.S.C. §441b(b)(2)(C) would not seem to prohibit it. Further, under 26 C.F.R. §1.501(c)(4)-1, an organization exempt from tax under §501(c)(4), i.e., operated exclusively for the promotion of social welfare, is not to treat "direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office" as promotion of social welfare. Thus, although the federal election laws do not appear to prohibit a §501(c)(4) tax-exempt corporation from making partisan communications to its stockholders or members, the tax laws would seem to preclude such activity.

These disparities in treatment under federal election laws and tax rules have different historical antecedents and emanate from different regulatory schemes. However, on balance, there is a large degree of symmetry between the tax rules and the federal election laws. For the most part, public electioneering activity by a §501(c)(3) or (4) tax-exempt corporation will be a violation of election law and contrary to the rules for retaining tax-exempt status.

V. Cooperation and coordination between the FEC and the IRS.

Recognizing that there are overlapping areas of concern, the FEC and the IRS have shared, and will continue to share information, and coordinate our respective functions to the extent feasible. The FEC has routinely sent to the IRS all relevant notices of rulemaking and proposed regulations. There has been ongoing interaction at the staff level regarding issues of mutual concern.

We at the FEC are sensitive to the separate policy-making function of the IRS. In the advisory opinions we issue, when appropriate, we include a statement to the effect that we do not address the application of federal tax laws. In these instances, we defer to IRS jurisdiction over such matters.

With regard to the specific area of tax-exempt organizations, our staff recently met with staff from the tax-exempt organization branch to discuss ways to more efficiently share information regarding enforcement within the strict confines of the confidentiality rules under which both agencies operate. At present, we make information about our closed enforcement cases available to the IRS at the earliest possible time. In addition, we are discussing methods by which each agency can access the other agency's public records in ways that will make the most efficient and timely use of both agency's resources.

VI. Conclusion

We hope that the foregoing summary of the FEC's role in regulating the political committees of tax-exempt groups or organizations is helpful to this Subcommittee. We stand ready to provide the Subcommittee with whatever other information or assistance it might request. If there are any questions at this time, we will attempt to answer them.

Mr. ANTHONY. Thank you very much, Mr. Thomas.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Actually, your laws and rules, your charter and mandate are different than the IRS; isn't that correct?

Mr. THOMAS. In large respect I think that is certainly correct.

Mr. SCHULZE. And yours might even be a little tougher. Do I read that?

Mr. THOMAS. Well, considering the folks that we deal with, it is certainly a very sensitive task that we have, and it involves the political process exclusively, which is a very difficult area to regulate.

Mr. SCHULZE. Do you get involved in determining whether we are talking about an educational effort or whether we are really talking about political activity?

Mr. THOMAS. On occasion that issue crosses our table. In the past, and we have provided some examples of this kind of situation, the Commission has been asked, for example, in the advisory opinion context whether a particular planned activity of a group or organization would amount to a contribution or expenditure in connection with Federal elections. We have struggled with those kinds of questions in the past.

As you know, our agency is composed of six members, and four votes are required to reach a conclusion on a particular matter. But yes, we have in the past had to address that question.

Mr. SCHULZE. Does it hinge largely on intent, or is intent very difficult to determine?

Mr. THOMAS. Intent is always very difficult to determine. That is the easier question. To the extent possible, we first, I think, try to examine objective factors. Of course, we are working with a statute that in its own definitional terms specifies that a "contribution" is something that is "for the purpose of influencing" a Federal election. So the purpose test does seem in some sense to be built into our calculations.

Mr. SCHULZE. Are you concerned that contributors are able to circumvent your restrictions through contributions to tax-exempt organizations?

Mr. THOMAS. In terms of the tax implications, that isn't our concern, no. From our perspective, our concern is whether any of these organizations that might be corporations have crossed the ban on corporations making contributions in connection with Federal elections, or alternatively, that they might have to register as a political committee.

Mr. SCHULZE. Do you see more potential for abuse in corporations than perhaps in charitable organizations? I don't know whether I worded that correctly.

Mr. THOMAS. I think what you may be getting at is that we don't focus on whether a particular organization is a charitable organization, a social welfare organization, a labor organization exempt under tax laws. What we focus on is whether it is, in the case of that statutory provision I referred to, a corporation of any kind or a labor organization of any kind.

Mr. SCHULZE. When you receive complaints, do you break them down as to whether they are tax-exempt organizations?

Mr. THOMAS. We do not.

Mr. SCHULZE. I was going to ask you whether you have seen an increase in complaints in regard to tax-exempt organizations. If you don't break them down, then I guess that is hard to answer unless you have a feel for it.

Mr. THOMAS. It is hard to answer because, with few exceptions, our Federal election rules do not use the tax rules at all as a guideline. I should add there are a few instances in our regulations, for example, where we do make a differentiation amongst organizations depending upon their tax status.

For certain tax-exempt organizations that are also nonpartisan, who do not support or oppose particular candidates, we have special rules that allow them, for example, to put out voter guides that would refer to the positions of candidates on issues and so on and so forth. But apart from those kinds of situations, it does not make a difference, and we don't keep those kind of statistics on which kinds of organizations are having complaints filed against them.

Mr. SCHULZE. Have you received complaints involving tax exempt organizations which have been affiliated with candidates or potential candidates?

Mr. THOMAS. This may sound like testimony you heard a moment ago in some sense. As you know, we have confidentiality rules as well under our statute. When anyone files a complaint with us, the investigation and so on must remain confidential. So in that respect, I cannot answer your specific question with regard to any pending cases that there may be.

I can tell you that we have in years past, certainly, dealt with the situation where individuals associated with a political action committee have then gone on to become a candidate. Usually this happens in the Presidential field, and we have had on several occasions compliance matters involving whether the disbursements by the PAC organization should in some sense be viewed as expenditures of the political campaign operation.

Mr. SCHULZE. Do you have any suggestions on that or do you want to reserve judgment at this time?

Mr. THOMAS. Again, for the most part our agency tries to follow a policy of not suggesting specific recommendations to Congress on substantive matters such as this. We intend to leave it to your judgment to come up with the best ways to solve these kinds of problems.

Mr. SCHULZE. Do you now try to track those things when you become aware of them if you are aware of a foundation or a charitable organization which is involved with a major candidate, or do you wait until it is brought to your attention?

Mr. THOMAS. I think in any official sense we wait until a complaint comes in the door. That, I think, is the preferred method for us to handle these matters in Congress' own judgment. I think that is the way our agency really was set up to operate. But that is not to say we don't keep track of these kinds of organizations in a general sense. Of course, our press office monitors newspapers throughout the country and the Commissioners are routinely apprised of those articles that appear in publications and so on that might relate to these kinds of issues.

We try to keep ourselves as informed as possible, but in terms of a specific program that we have set up to identify these kinds of activities, none exists now.

Mr. SCHULZE. It seems to me the FEC's charter pretty much goes in the direction of full disclosure. Do you think that serves you well and helps eliminate abuse? I am not at this point saying that we should have full disclosure of all charitable contributions. I don't want to even think that. But do you think that you have fewer abuses because of the disclosure requirements in your Commission?

Mr. THOMAS. I think without question the disclosure aspect of the Federal Election Campaign Act has served a vital purpose and I think that it has instilled a sense of confidence in the Federal election process. I think that really cannot be seriously questioned. I think also it does perform an important function in ensuring compliance with the other provisions of the law, the contribution limitations, the requirements that organizations not take moneys from prohibited sources and so on.

So I think the disclosure program certainly aids that process. If, for example, an organization which may be a tax-exempt organization were to make transfers of funds to a political action committee of some sort, because the political action committee does have to report its receipts to the Federal Government, that would assist the ability of the Federal Government, the FEC, for example, to monitor whether a tax-exempt organization is somehow using its funds for political purposes.

Mr. SCHULZE. How do you address the issue of common control of tax-exempt organizations and PAC's? Or do you not address it unless there is a violation of some kind?

Mr. THOMAS. We have under our own statute a fairly general but a helpful affiliation rule that is spelled out. In essence, all political committees that are established or financed or maintained or controlled by the same person are to be deemed affiliated political committees. We have promulgated regulations that attempt to flesh this out a bit. We try to identify factors, for example, the ability of one organization to control or hire or fire the officers of another organization, and so those rules to some extent are in place under Federal election law.

So if, I suppose, the situation were brought to our attention where it was fairly apparent that a group which was not considering itself to be a political committee was somehow tied in in a sense that would satisfy the Commission that it was affiliated under those rules, then the issue would arise as to whether that organization itself should be treating itself as a political committee.

Mr. SCHULZE. Thank you.

Thank you, Mr. Chairman.

Mr. ANTHONY. Mr. Dorgan.

Mr. DORGAN. Mr. Chairman, let me ask you a couple of questions. First let me give you a hypothetical, and it could apply to a Democrat or a Republican.

A generic politician decides today he is running for President and sets up a tax-exempt organization, and the issue is stopping the arms race. So they set up a tax-exempt organization and they start putting out position papers on behalf of this person. The person charters a jet aircraft to move all around America speaking.

They prospect in fundraising by sending direct mail all across America to find out who are the 850,000 hard core good givers on this issue and develop that list.

Then, even though everybody in America knew this person was running for President but had not formally announced it, 10 months later, after all of that was paid for through a tax-exempt organization under the aegis of education, there is a news conference that this person is now a candidate for President.

All of the activities that preceded that news conference appear in retrospect to have been completely political for the purpose of promoting that candidacy, and then they sell the name list, having gone through the expensive prospecting for names for direct mail solicitation, they sell that to the candidate at market value, whatever that is.

Does any of that trouble the FEC? If in that process of events it troubles the FEC, would you have taken action at some point? If not, why not? That is a hypothetical, but I am curious what your position is.

Mr. THOMAS. I always take the risk in responding in a situation like this of interesting other members of the Commission. As I indicated, there are six members of our Commission, so any comment that I would make I would have to preface, of course, with the remark that it would be my own personal view.

Some of those areas obviously do touch on Federal election rules. In the first place, if an organization does, in some sense, cross the line and, by any kind of objective criteria or through examination of—perhaps if it got to that point—examination of persons involved, it were determined that it was fairly clear what the purpose of the activities were, they would cross the line of being contributions or expenditures for the purpose of influencing the Federal election, then of course yes, we would be in the posture of trying to determine whether the group should register, whether it has crossed the border in terms of being a corporation that made prohibited expenditures.

Mr. DORGAN. Would that have to come to you in the form of a complaint, or might you initiate that?

Mr. THOMAS. That, of course, is the primary way in which that kind of matter would get the commission's interest. A complaint would generally have to be filed in order to initiate that kind of matter.

Mr. DORGAN. So in terms of enforcing election laws and in terms of dealing with those who attempt to circumvent those laws, you do not have an enforcement mechanism that analyzes what is happening out there and deals with it. Would you wait, or would present practice persuade you to wait until someone would complain about it? Is that the case?

Mr. THOMAS. I think that certainly the primary way in which we would come by that kind of issue, we would address that kind of issue, would be through the complaint process. I would also note we do have a very sophisticated program for monitoring all of the financial reports that are filed by Federal candidates and Federal political committees and so on and so forth.

And to that extent, if, in the case of the list which you mentioned, if based on public disclosure someone saw that a list had been purchased by the political committee, the Presidential campaign committee, that was ultimately formed and if a member of the public felt that there was evidence somewhere that that list was worth much more than the reports show was paid, then the matter might come to us through that way. But our disclosure program would allow for that opportunity as well. And we, of course, review those reports ourselves and look for any indication that an in-kind contribution in excess of the limits has been received.

Mr. DORGAN. I used a hypothetical to begin this, but you and I both know, without mentioning any names, that there are at least a half a dozen, and probably many more, of that type that now exist, on behalf of a whole range of political candidates from both sides of the aisle. Do you think we've got a problem in this area that we ought to look at? Do you think skirting the fringes of the Federal election law is a problem that you are not able to do something about at this point and wish you could do something about?

Mr. THOMAS. Well again, I won't suggest that we at the commission are going to come forward on our own and make any legislative recommendations in this area, because as I said, we generally steer away from that. But I think that based on our experience in past election cycles where we have discovered, for example, as I said, political action committees formed by persons who later become candidates, and that those committees have in some fashion made in-kind contributions to the Presidential campaign, we do get into those areas, and it is inevitable.

I think—guessing, but I think that partially perhaps in response to hearings such as this, there is going to be a heightened interest in these issues. I suspect it is likely there will be more complaints filed with our agency. We will be put in the position of looking into more of these kinds of situations.

I would caution, of course, that any complaint that is filed, in order to give the Commission a reason to believe that a violation exists, has to give us some substantiation that indeed the lines have been crossed.

Mr. DORGAN. I would like to ask the Vice Chairman for his opinion. The reason I asked the question is that we put you in the position of having to be the referees on election law violations, and in my judgment we've got a whole lot of lawyers advising people to skate right around the fringes these days. I am wondering whether it's a problem for you. If so, I'm not asking that you recommend how we solve it, but I think it is appropriate for us to ask you if you see a problem brewing. Because we need to find out whether you have the same kind of concerns that some of us see.

Let me ask Mr. Josefiak.

Mr. JOSEFIAK. Well Congressman, if you were a fly on the wall just on Tuesday, which is our executive session meeting day, you would understand the conflicts that the Commission finds itself in, in dealing with fundamental first amendment rights and how far the statute goes.

But I guess I have to reemphasize what the Chairman said earlier, that it doesn't matter to us the status of an organization. If we feel from the evidence presented either externally from a complaint or internally generated through our own review process or our audit process, that we will investigate those contributions or expenditures, at least at that point that are so perceived. And sometimes we come to the conclusion there are in fact illegal contributions being made and we will take actions. Other times, the evidence is insufficient for us to make those determinations and we will dismiss the case.

But it is important to note that we will look at all complaints filed for legitimacy and we will look at, under our law, what a definition of a contribution is, what a definition of an expenditure is. If they meet those definitions it doesn't matter whether they are tax exempt or not.

So whether or not attorneys are advising their clients to do X, Y and Z, we will look at that and if we feel that X, Y and Z is a violation of the law we will proceed against them.

Mr. DORGAN. Is there is a growing problem here, in your judgment?

Mr. JOSEFIAK. I am not sure if it's a growing problem. I think when you are looking at an agency like ours, which is probably 11 years old, and you look at the number of changes over the years amending the law, there is more sophistication in the practitioners of that law. If you go back to the beginning in 1976 to that first Presidential race, it almost looks like you are in medieval times; it just has no resemblance to how campaigns are run in 1987 for the 1988 election or even in 1986 for the 1988 Presidential campaign.

Let me give you another example. In the 1984 process we thought, in addressing regulation changes, that we could address every possible potential Presidential election law problem. But as a result of the 1984 election we are still embroiled in our own audit of the 1984 Presidential campaigns. So it's an ongoing, sophisticated process where we revised the regulations, the practitioners out there look at them and devise more imaginative ways of dealing with the election laws.

So from that standpoint it is not necessarily more of a problem, it's more of a sophisticated approach to the election law.

Mr. SCHULZE. Would the Chairman yield on that point? Mr. Chairman, as you went through that example, I found myself emotionally agreeing with you. It seems to me you have the additional problem that if a newsman or an anchorman on a major network or on a local television station suddenly becomes a candidate, do we say you cannot appear anymore, or you've got to stop, or we cut it off but we sort of forgive what has happened in the past? Am I correct on that?

Mr. JOSEFIAK. Well, it is not that easy, Congressman. We just recently had an advisory opinion request seeking advice as to how involved a candidate's business could be with the candidate's campaign. And the Commission could not resolve that issue. How far can you go when specifically we have a person who runs for Congress and you're trying to deal with the fact he's the president of a station and you're trying to deal with whether or not, as president, he can appear on an editorial of the station when, under our law, an editorial is exempt from the normal rules about prohibited corporate contributions.

So if you are a network and you want to say, I want you to defeat candidate X, and go to the polls and do it, you can do it and that's not a problem. But if you are also the candidate and you are on the air doing a series of editorials, not touting your candidacy but through that process involving yourself with the electorate to the degree that others don't have that opportunity, where do we draw the line. And the Commission did not address that issue.

Mr. **Schulze**. That's what I was getting to. It seems to me that it's a lot more complicated if a Member of Congress or a potential candidate had diabetes and went on television discussing the disease or epilepsy, or had a child with a learning disability or almost anything. You could later look back and say well, his motives were not the best; he was really running for Congress but became prominent in that organization in order to do that.

So it seems to me we have given you almost an impossible task, to sit down and look at people's motives. And I thought perhaps you had a system devised where you had a firm cutoff, but the example you raised even makes that more complicated.

Mr. **Josefiak**. Congressman, the Commission has grappled with those kinds of issues; the intent issue, the message issue. The courts have grappled with that issue and continue to grapple with that issue and hopefully some day we will be able to resolve it through an evolving process. But I guess that's why we have a six-member Commission and you need four members of the Commission to take any action.

Mr. **Dorgan**. In my hypothetical, I was not suggesting there was any question about motives. Everyone understands the kind of example I was describing is a person running for President. The alternative example is an organization designed to get tax-exempt money to influence an election by television commercials.

I was trying to understand whether you see this as a problem. In tax law when we talk about the increasing sophistication of the practitioners, we're talking about the deluge of new ads saying, here is how you can avoid your taxes. This creates the fringe and it creates enormous problems in tax compliance and enforcement.

I was wondering whether that same sophistication that you talked about is creating enforcement problems for the FEC. My best guess is that it is, but I'm not sure I am able to get a short answer that says that. Maybe the answer is that it is not creating problems.

Mr. **Josefiak**. Well, you come down again to interpretation, in my mind at least, of specific words, and your philosophy of how you view the Federal Election Campaign Act. I think that is where the problem comes in.

Mr. **Dorgan**. Two other very quick questions. Does the FEC review the form 990's filed with the IRS when a complaint is received?

Mr. **Thomas**. We do not. Unless, of course, it came up as a piece of evidence of some sort in an enforcement matter or an advisory opinion request or something like that. But as a matter of course, no, we don't do it routinely.

Mr. **Dorgan**. When a complaint is received, should you probably look at that form 990?

Mr. **Thomas**. I think certainly it would be a relevant piece of information and I think to the extent it would show any evidence that would be relevant to our considerations, a good investigator or lawyer would ask for that information. Yes.

Mr. **Dorgan**. And one brief final question, when you uncover questionable activities by tax-exempt organizations, is there a return flow of information? Would you routinely, as a matter of practice, alert the IRS at this point?

Mr. **Thomas**. As I said, we recently had a meeting with the IRS folks. It is our understanding that they had been reviewing our closed compliance cases. I think beyond that we are considering with them if there are ways that we can exchange other kinds of information we have. We have lists of respondents that have gone through the enforcement process, for example, and I think that kind of information would be helpful to them because then they can check whether to take a look at any of these organizations.

We also have other information that might be of assistance to them and we are working on ways to see whether we can set up an ongoing liaison with them so that we can better understand what they have done and likewise they can understand what we have done.

Mr. **Dorgan**. Thank you very much, Mr. Thomas. I want to thank the panel very much. It's a difficult area and we understand some of the problems. So we thank you very much for appearing and sharing your thoughts with us today.

Next, the Chair calls on a panel comprised of John Jones, the chairman of the Section of Taxation, American Bar Association; William J. Lehrfeld, Lehrfeld & Henzke; Leonard L. Silverstein, Silverstein & Mullins.

We would like the audience to take their seats, please, and we would like to welcome the panel. We would appreciate it if the panel would summarize their statements. We would intend to include their full statements in the hearing record.

And we would first like to hear today from John Jones, Jr., who is the chairman of the Section of Taxation with the American Bar Association.

Mr. Jones, welcome to the panel.

STATEMENT OF JOHN B. JONES, JR., CHAIR, SECTION OF TAXATION, AMERICAN BAR ASSOCIATION, ACCOMPANIED BY STEVEN SIMPSON, COMMITTEE ON EXEMPT ORGANIZATIONS

Mr. **Jones**. Thank you very much, Mr. Chairman.

I am speaking today for the Section of Taxation, not for the full Bar Association, which has not had time to pass on these matters.

I am accompanied by Steven Simpson, a member of our committee on exempt organizations, which has responsibility for preparing our statement.

We have confined our statement to deal with public charities and basically what the law is on lobbying activities, not political activities, of these public charities. Our approach was to set forth for the committee a rather complete history of the development of the law in this area. We think that the law has developed carefully over time, has been responsive, has drawn a reasonable balance on the very difficult competing considerations. It's a sensitive area. There are first amendment implications. On the other side, there is an obvious distaste in everyone's mouth when people get a tax exemption from the Federal Government and take this exemption to compete in the political arena with other organizations that are not so favored. And we think the history is set forth here in good manner. I'm not going to repeat it. It's also been done very well for the committee by Mr. Hopkins and Secretary Mentz.

Just by saying that the law has developed carefully does not mean, of course, that it's perfect, and there have been recited before the committee reasons for change. But we would emphasize, as others before us have, that the areas of change come on the fringes. It is not in the great bulk of these very valuable organizations that carry on their work. They don't make the problems which the committee is considering today.

And so when the committee addresses these problems, we hope very much it will have in mind a balance which will not put a burden on the good organizations as we go after these abusers.

In particular, in the lobbying area, it is very easy to get to some kind of subjective test which is very hard to administer. And being hard to administer means not only that good people get into problems; it means that they spend a lot of time and energy on what is not a very productive area.

Now these comments do not apply to political activity. I think political activity and intervening in elections, however difficult that may be to define, is much, much easier than determining when organizations are lobbying. When you talk about lobbying, it's very close to the expression of ideas. It's very hard to draw the exact line. But we feel that as the committee deals with political actions, one can be more Draconian and take stronger positions.

In general, we feel that the comments today, both from the witnesses and from the members of the committee, have been consistent with these principles. It was very carefully set forth in the notice of this meeting that we are not now addressing the proposed regulations of the Internal Revenue Service. We are making similar comments there—that it's a very dangerous thing to deal with abuses by setting forth new standards that will introduce uncertainty, controversy, and cause the 501(c)(3) organizations to divert their attention.

And so I would just conclude that the committee maintain its concern for the hundreds of thousands of (c)(3)s that don't come anywhere close to violating the line and realize that new rules that are difficult to administer will come down very heavily on them.

Thank you.

[The prepared statement follows:]

STATEMENT OF JOHN B. JONES, JR. ON BEHALF OF THE SECTION OF TAXATION OF THE AMERICAN BAR ASSOCIATION IN REGARD TO THE OVERALL, BASIC DEFINITIONS OF LOBBYING AND POLITICAL ACTIVITIES OF EXEMPT ORGANIZATIONS

Mr. Chairman and Members of the Subcommittee:

I. INTRODUCTION.

I am John B. Jones, Jr., Chair of the Section of Taxation of the American Bar Association and I am pleased to have this opportunity to present the Section of Taxation's views on certain activities of public charities that constitute attempts to influence legislation (so-called "lobbying activities." These views are presented only on behalf of the Section of Taxation. They have not been approved by the House of Delegates or the Board of Governors of the American Bar Association and, accordingly, should not be construed as representing the position of the Association.

The Section's comments generally discuss the historical treatment of lobbying by public charities under the federal income tax laws. Public charities are generally those organizations recognized as exempt from federal income taxation under section 501(c)(3) of the Internal Revenue Code of 1986 ("the Code")1/, and treated as other than private foundations under section 509(a). The Section's comments also briefly discuss the definition and certain examples of lobbying activities contained in proposed regulations recently issued by the Internal Revenue Service under sections 501(h) and 4911 of the Code.

This submission does not address political campaign activities of public charities (so-called "electioneering activities") or attempts to influence legislative committees by private foundations that qualify as taxable expenditures under section 494 of the Code.

II. HISTORY OF LOBBYING BY PUBLIC CHARITIES

A. Statutory and Regulatory Development.

1. Section 501(c)(3) Generally.

Organizations that are organized and operated exclusively to further charitable, educational, religious, and certain other enumerated purposes are treated as exempt from federal income taxation under the Internal Revenue Code. Section 501(c)(3) states in part as follows:

> Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes . . . no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office [are exempt from federal income taxation].

Thus, an organization may qualify for exemption under section 501(c)(3) if three conditions are met:

1/All references to "section" herein are to sections of the Code.

> (1) It must be both organized and operated primarily to accomplish one or more proper exempt purposes;
>
> (2) No part of its net earnings may inure to the benefit of private shareholders or other individuals; and
>
> (3) No substantial part of its activities may consist of attempts to influence legislation and it may engage in no political campaign activities whatsoever.[2]

Thus, a public charity exempt under section 501(c)(3) may engage in activities constituting attempts to influence legislation so long as those activities do not constitute a substantial portion of its overall activities. In contrast, an organization may engage in no more than de minimis political activities,[3] as the substantiality test applies only to legislative activities. By its terms section 501(c)(3) absolutely prohibits electioneering activities.

2. Revenue Act of 1934.

The limitation against substantial lobbying activities by public charities originated in the Revenue Act of 1934,[4] section 101(6), which amended the predecessor of section 501(c)(3) to provide that an organization may be exempt thereunder only if no substantial part of the activities of the organization is carrying on propaganda, or otherwise attempting, to influence legislation.

Prior to the enactment of the Revenue Act of 1934, the leading case on organizations engaging in legislative activities was Slee v. Commissioner.[5] In this case, the American Birth Control League distributed information to legislators and the public which argued that certain laws preventing birth control should be repealed. At that time, the predecessor of the current statute only required that the organization be organized and operated exclusively to accomplish a proper exempt purpose. The court held that the organization's distribution of information recommending changes in birth control laws to legislators and others prevented the organization from being operated and organized exclusively to further a proper exempt purpose.

---

[2] Reg. § 1.501(c)(3)-(1)(c)(1); e.g., Church of Ethereal Joy v. Commissioner, 83 T.C. 20, 21 (1984). In addition, an organization must also comply with fundamental notions of public policy. Bob Jones University v. United States, 461 U.S. 574 (1983); Church of Scientology of California v. Commissioner, 83 T.C. 381, 502-09 (1984).

[3] GMC 39414. The Tax Court has occasionally applied the substantial test to political activity. PLL Scholarship Fund v. Commissioner, 82 T.C. 196, 198 (1984); Greater United Navaho Enterprises v. Commissioner, 74 T.C. 69, 76 (1980).

[4] Revenue Act of 1934, P.L. 73-216, ch. 277, section 101(6), 48 Stat. 700 (1934). The legislative history indicates that the amendment to section 101(6) may have simply been made to conform to an amendment to section 23(o), the predecessor of section 170, to deny a charitable contribution deduction for contributions to organizations a substantial part of whose activities consisted of carrying on propaganda or otherwise attempting to influence legislation. S. Rep. No. 558, 73d Cong., 2d Sess. (1934), reprinted in 1939-1 (Part 2) C.B. 586, 606, 609 (1939).

[5] 42 F.2d 184 (2d Cir. 1930).

> Political agitation as such is outside the statute, however innocent the aim, though it adds nothing to dub it "propaganda," a polemical word used to decry the publicity of the other side. Controversies of that sort must be conducted without public subvention; the Treasury stands aside from them.[6]

Congress thereupon amended the predecessor of section 501(c)(3) in the Revenue Act of 1934 to prohibit an organization from engaging in substantial activities constituting attempts to influence legislation and, in 1954, amended the statute to prohibit absolutely political campaign activity.[7]

3. Section 501(c)(3) Regulations and Case Law.

a. Section 501(c)(3) Regulations.

The regulations under section 501(c)(3), promulgated in 1959, state that an organization is not considered to be operated exclusively for a proper exempt purpose if it is an action organization.[8] An organization is said to be an action organization if a substantial part of its activities is attempting to influence legislation by propaganda or otherwise. An organization is regarded as attempting to influence legislation if the organization itself contacts (so-called "direct lobbying") or urges the public to contact (so-called "grass roots lobbying") members of a legislative body for the purpose of "proposing, supporting, or opposing legislation," or the organization "advocates the adoption or rejection of legislation."[9] The term "legislation" includes action by the Congress, a State legislature, a local governmental body, or a public referendum. Thus, the section 501(c)(3) regulations require affirmative support or opposition to legislation, either then pending or to be proposed, in order for an organization to have committed an attempt to influence legislation. An organization may also be considered an action organization if its main or primary objective may be obtained only by legislation or a defeat of proposed legislation and it advocates the attainment of that primary objective, instead of engaging in "nonpartisan analysis, study, or research and making the results thereof available to the public."[10]

b. Case Law.

The courts have long struggled with the issues raised by the "substantial" test.

In 1955, in the case of Seasongood v. Commissioner,[11] the court held that the expenditure of 5 percent of an organization's budget on lobbying activities did not constitute substantial lobbying activities. In Christian Echoes National Ministry, Inc. v. United States,[12] the organization published articles and broadcast radio and television programs which argued against the spread of communism, socialism and political liberalism, which were considered antithetical to the Christian and Western way of life. Articles in newsletters and other written materials appealed to readers to write to their congressmen in order to influence national political decisions and urged them to work in local precinct political campaigns, support prayer in the public schools, demand that Congress limit foreign aid spending, and terminate diplomatic relations with communist countries. The court held that these grass roots lobbying activities constituted a substantial portion of the organizations overall activities and upheld the Service's revocation of the organization's exemption.

---

[6] Id. at 185.

[7] Section 501(c)(3) of the 1954 Code.

[8] Reg. § 1.501(c)(3)-1(c)(3)(i).

[9] Reg. § 1.501(c)(3)-1(c)(3)(ii)(a),(b).

[10] Reg. § 1.501(c)(3)-1(c)(3)(ii), (iv).

[11] 227 F.2d 907 (6th Cir. 1955).

[12] 470 F.2d 849 (10th Cir. 1972), cert. denied, 414 U.S. 864 (1973).

The court criticized the Seasongood percentage test.

> The political activities of an organization must be balanced in the context of the objectives and circumstances of the organization to determine whether a substantial part of its activities was to influence or attempt to influence legislation. (Citation omitted.) A percentage test to determine whether the activities were substantial obscures the complexity of balancing the organization's activities in relation to its objectives and circumstances. (Citing the Seasongood case.) An essential part of the program of Christian Echoes was to promote desirable governmental policies consistent with its objectives through legislation.[13]

The court's opinion in Christian Echoes may have been overbroad. References in the opinion to "appeals to the public" and "attempts to mold public opinion" are inconsistent with the Service's own regulations, which permit an organization to advocate social or civic changes or present opinion on controversial issues with the intention of molding public opinion or creating public sentiment to an acceptance of its views.[14]

Also critical of the Seasongood percentage test was Haswell v. United States.[15] In Haswell, the court found that the organization's lobbying expenditures, which amounted to 20 percent of its total expenditures, constituted substantial legislative activities, while purporting to disclaim any reliance on the percentage test set forth in Seasongood.[16] The court held that attempts to influence legislation were a primary objective of the organization's total activities.

Finally, in League of Women Voters of United States v. United States,[17] the court looked to the organization's employees' time spent on legislative matters in reaching its conclusion that the organization's legislative activities constituted a substantial part of its overall activities.

The percentage test in any case favors larger organizations over smaller organizations, since 5 percent of a large budget will constitute a larger dollar amount than 5 percent of a smaller budget.[18] This confusion over the scope of the substantiality test led to the enactment of sections 501(h) and 4911 of the Code.

---

[13] Id. at 855 (emphasis in original).

[14] Reg. § 1.501(c)(3)-1(d)(2).

[15] 500 F.2d 1133 (Ct. Cl. 1974), cert. denied, 419 U.S. 1107 (1975).

[16] Id. at 1145.

[17] 180 F.Supp. 379 (Ct. Cl.), cert. denied, 364 U.S. 882 (1960).

[18] P. Treusch and N. Sugarman, Tax-Exempt Charitable Organizations 156 (2d ed. 1983).

B. Tax Reform Act of 1976.

Section 1307 of the Tax Reform Act of 1976 [19] enacted sections 501(h) and 4911 of the Code. These provisions were intended to set specific expenditure limits for lobbying activities to replace the uncertain standards of prior law and to allow evenhanded administration of the restrictions against substantial lobbying activities. Section 501(h) was intended to set clear and certain standards for lobbying activities, in contrast to the uncertainty caused by the substantiality test. The provisions of Section 501(h) are elective; if its provisions are not elected, the organization will remain subject to the substantiality test of section 501(c)(3).

1. Section 501(h) Election.

If an organization elects to be treated under section 501(h), the Service may not revoke its exemption or refuse to recognize its exemption due to substantial activities consisting of carrying on propaganda or otherwise attempting to influence legislation unless the organization normally makes lobbying expenditures in excess of the lobbying ceiling amount for that organization for each taxable year or normally makes grass roots expenditures in excess of the grass roots ceiling amount for the organization for each taxable year. Section 501(h)(1).

2. Attempts to Influence Legislation.

Section 4911 defines the term "influencing legislation" for purposes of section 501(h) as any attempt to influence any legislation through an attempt to affect the opinions of the general public or any segment thereof ("grass roots lobbying")[20] or any attempt to influence legislation through communications with any member or employee of a legislative body or with any government official or employee who may participate in the formulation of the legislation ("direct lobbying").[21]

The term "influencing legislation" expressly does not include the following matters:

> 1. Making available the results of nonpartisan analysis, study, or research;
>
> 2. Providing of technical advice or assistance (where such advice would otherwise constitute the influencing of legislation) to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision as the case may be;
>
> 3. Appearances before, or communications to, any legislative body with respect to a possible decision of such body that may affect the existence of the organization, its powers and duties, tax-exempt status or the deduction of contributions to the organization (so-called "self-defense direct lobbying");

---

[19] P.L. 94-455, 1307, 90 Stat. 1720 (1976) (hereinafter the "1976 Act").

[20] Section 4911(d)(1)(A).

[21] Section 4911(d)(1)(B). Section 4911 thus expands the definition of attempts to influence legislation set forth in the regulations under section 501(c)(3), which omit any mention of direct contacts with nonlegislative branch employees who may participate in the formulation of legislation. Reg. § 1.501(c)(3)-1(c)(3)(ii), (iv).

4. Communications between the organization and its bona fide members with regard to legislation or proposed legislation of direct interest to the organization and such members, other than communications with members that encourage the member himself to engage in direct or grass roots lobbying activities; and

5. Any communication with a governmental official or employee other than a communication with a member or employee of a legislative body where the communication would otherwise constitute the influencing of legislation or a communication the principal purpose of which is to influence legislation.[22]

The Service has recognized several situations where activities undertaken by tax exempt organizations have been held not to constitute attempts to influence legislation.[23]

3. Lobbying Nontaxable and Ceiling Amounts.

The lobbying nontaxable amount for an organization, which is the permitted level of lobbying expenditures, is 20 percent of the first $500,000 of the organization's exempt purpose expenditures for the year, plus 15 percent of the second $500,000, plus 10 percent of the third $500,000, plus 5 percent of any additional expenditures, but not to exceed $1,000,000 for any one year. The grass roots nontaxable amount is 25 percent of the lobbying nontaxable amount for any taxable year. Thus, the lobbying nontaxable amount will differ from organization to organization, depending upon the level of the exempt purpose expenditures.

The lobbying ceiling amoun. for an organization for any taxable year is 150 percent of the lobbying nontaxable amount for the organization for that year, determined under section 4911. The grass roots ceiling amount for an organization for any taxable year is 150 percent of the grass roots nontaxable amount for such organization for such taxable year, determined under section 4911.

The determination of whether an electing organization's lobbying expenditures are within its lobbying non-taxable amount is made by comparing the amount of its lobbying expenditures to the organization's "exempt purpose expenditures" for the taxable year. The term "exempt purpose expenditure" includes the total of amounts paid or incurred by the organization to accomplish its exempt purposes, as well as its administrative and lobbying expenditures, but such term excludes certain payments for fundraising purposes.[24]

---

[22] Section 4911(d)(2)(A)-(E).

[23] For example, a university which provided facilities and faculty advisors for a campus newspaper that published students editorial opinions on political and legislative matters was held not to be attempting to influence legislation or participating in political campaigns. Rev. Rul. 72-513, 1972-2 C.B. 246. Similarly, a nonprofit organization which assisted local governments of a metropolitan area by conducting research to develop solutions for common regional problems, but which did not advocate any legislative action to implement its findings, was found not to be involved in legislative activities so as to jeopardize its tax-exempt status under section 501(c)(3). Rev. Rul. 70-79, 1970-1 C.B. 127. Likewise, an exempt organization was found not to be engaged in prohibited legislative activity if, at the request of a legislative committee, a representative testified as an expert witness on pending legislation affecting the organization. Rev. Rul. 70-449, 1970-2 C.B. 112.

4. Other Definitions.

The term "legislation" includes action with regard to acts, bills, resolutions or other actions by the Congress, a State legislature, any local council or similar governing body, or any public referendum or initiative.[25] The term "action" is limited to the introduction, amendment, enactment, defeat, or repeal of acts, bills, resolutions, or similar items.[26] Therefore, the statutory definition of attempts to influence legislation requires that a legislative resolution or bill or similar item be the subject of pending or prospective legislative consideration. With regard to the "introduction" of legislative actions, it may be difficult to foresee what bills might be introduced at any particular legislative session.

5. Other Rules.

There are also certain affiliation rules set forth in the statute to prevent the formation of a group of related organizations to avoid the decreasing percentage test in the 1976 Act.[27] The 1976 Act also added section 6033(b)(8) which requires an organization on its Form 990 to disclose its lobbying and grass roots expenditures and the lobbying and grass roots nontaxable amounts.

6. Penalties for Excessive Lobbying Expenditures.

An electing organization that exceeds either the lobbying nontaxable amount or the grass roots nontaxable amount in a taxable year is subject to an excise tax of 25 percent on its excess lobbying expenditures. If an electing organization's lobbying expenditures normally (on average over a four-year period) exceed 150 percent of the lobbying nontaxable amount or the grass roots lobbying nontaxable amount, the organization will forfeit its exempt status under section 501(c)(3). In such a case, an organization is not there after permitted to become exempt under section 501(c)(4).

If the organization's expenditures to influence legislation exceed both the lobbying nontaxable amount and the grass roots nontaxable amount, then the 25 percent excise tax is imposed upon whichever of these excess amounts is the greater.[28]

---

[24] Section 4911(e)(1)(A)-(C).

[25] Section 4911(e)(2).

[26] Section 4911(e)(3).

[27] Section 4911(f).

[28] Staff of Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, H.R. 10612, 94th Cong., 2d Sess. 408 (1976); B. Hopkins, The Law of Tax-Exempt Organizations, § 13.4 at 238 (4th Ed. 1983).

III. THE SERVICE'S PROPOSED REGULATIONS UNDER SECTIONS 501(h) and 4911

In November, 1986, the Service published proposed regulations under sections 501(h) and 4911 ("Proposed Regulations"). The Section of Taxation will submit comments to the Service concerning the Proposed Regulations at an appropriate time. This portion of the Section's submission discusses only the definition of attempts to influence legislation set forth in the Proposed Regulations.

The Proposed Regulations provide that a communication constitutes an attempt to influence legislation through direct lobbying if the communication meets the following three requirements:

> 1. The communication "pertains to" legislation being considered by a legislative body, or "seeks or opposes" legislation;
>
> 2. The communication reflects a view with regard to the desirability of the legislation; for this purpose, a communication that pertains to legislation may be deemed to reflect a view on legislation if the communication is selectively disseminated to persons reasonably expected to share a common view of the legislation, even though the communication expresses no explicit view on the legislation, and
>
> 3. The communication is either (a) with a member or employee of a legislative body, or (b) with a governmental official or employee other than a member or employee of a legislative body who may participate in the formulation of legislation, but only if the principal purpose of the communication is to influence legislation.[29]

A communication constitutes a grass roots lobbying activity if the communication meets the first two elements set forth above for a direct lobbying communication and is also communicated in a form and distributed in a manner so as to reach individuals as members of the general public in their capacities as voters or constituents, as opposed to a communication designed for academic, scientific or similar purposes. A news release that reaches the public indirectly may qualify as a grass roots lobbying communication under this standard.[30]

The Section will advise the Service of its concerns about the Proposed Regulations and provide technical assistance to the Service in its consideration of the comments that may be filed.

IV. CONCLUSION

The Section of Taxation of the American Bar Association is pleased to have had this opportunity to present its analysis of the historical development of lobbying activities by public charities. The Section expresses its willingness to assist the Subcommittee on Oversight of the Committee on Ways and Means in its review of such activities in any way that the Subcommittee may deem appropriate. The Section hopes that this submission will be of assistance to the Subcommittee in its deliberations.

---

[29] Prop. Reg. § 56.4911-2(a)(2).

[30] *Id.* at (c)(1).

4718P

Mr. ANTHONY. Mr. Jones, thank you very much for the testimony.

Next we will hear from William Lehrfeld.

STATEMENT OF WILLIAM J. LEHRFELD, LEHRFELD & HENZKE, P.C., WASHINGTON, DC

Mr. LEHRFELD. Mr. Chairman, I'm a little disappointed with the Tax Section's remarks. I haven't had the opportunity to read their written statement, but if you wouldn't mind, rather than reading from my testimony, I would like to read from the 1972 ABA statement, which I think, it seems to me, says it better:

> We believe the federal tax system, like the First Amendment to the Constitution, should encourage organizations to obtain what they think is due them, their constituency, or the public from government. While the plethora of claims, facts, and arguments may appear to the Congress confusing, annoying, and perhaps at times deceiving, it is in the larger interest of free government, which allows the greatest access to Congress, so that it or any other legislative body may act as the final arbiter of all demands.

And in that connection, the ABA House of Delegates approved in 1969 a provision which would have the effect of repealing existing law with respect to direct action, direct congressional action or concern for it by the exempt organizations community.

And along that same line, my testimony takes the position that the current law, the 1934 and the 1976 changes, represents in one form or another a taxation of ideology. It is an attempt to avoid freer expressions of press, religion, and muffle the public's right to seek redress of its grievances through its common institutions.

It is also an opportunity for mischief by Members of the Congress and by members of the executive branch to intimidate the nonprofit sector by claiming that perhaps they are indulging or overindulging in the expression of their views on legislative matters, and therefore should be silenced by the Internal Revenue Service, acting as a tool of congressional opinion.

I think you can start with the 1934 amendments where Senator Reed, as Mr. Hopkins pointed out, attempted to revoke or bring to the Congress' attention the tax-exempt status of the National Economy League. After the 1934 amendment was enacted, the Internal Revenue Service obliged and revoked that organization's tax-exempt status 3 months later.

You have Martin Dyes, Parnell Thomas, John Buchanan, Carroll Reece, and Senator Harry Byrd and a number of others who have all used these political activity limitations to attempt to get the organization stifled, to have their voice not heard. It seems to me that we're never going to get away from this type of mischief, if you continue to enforce existing law or continue to walk around the fringes that are created by such changes as found in the 1976 act.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement On Legislative And Political Campaign Activity By Exempt Organizations

---

William J. Lehrfeld

Lehrfeld & Henzke, P.C.
1101 Connecticut Avenue, N.W.
Suite 403
Washington, D.C. 20036

202/659-4772

The legislative provisions now found in Section 501(c)(3) of the Internal Revenue Code, and the 1976 elective provisions including 501(h) and 4911, should be repealed: History has shown both the Internal Revenue Service and the Congress have attempted to use these limitations to serve petty political purposes, inhibit public debate, and punish the free exercise of press, religion and right of Americans to seek a redress of grievances from Government. The elective provisions are an utter failure with less than one percent of the charitable community seeing the 1976 changes as an advantage over the existing law.

Historically, the Internal Revenue Service and the Congress share in their obvious desire to popularize bland, noncontroversial, unintrusive organizations. The public record is rampant with administrative actions which sought to bar, from the characterization of educational or charitable, organizations which were ardent in their attempts to educate the public, which created controversy with the views espoused, or as an incident to their charitable and educational programs, addressed the Congress about important topical matters which needed redress. Congress, on its own initiative, through particular members, have used the legislative process to punish organizations which some Members individually or collectively, found offensive. By creating the legislative ban, it denies to the public sector the ordinary civil rights of free speech and debate.

I.
INTERNAL REVENUE SERVICE

In its earliest history, even before the enactment of the charitable contribution deduction, the Internal Revenue Service sought to deter the full, free and fair exposition of differing views on economic or business matters by attempting to deny a business expense deduction for attempts at changing statutes.

T.D. 2137, 17 Treasury Decisions of IRS, at 5758 (1915).[1] A comparable negative approach was taken by holding that the term "educational" did not include any statement of a viewpoint which was controversial or partisan. Treas. Regs. 45, Art. 517.

Partisanship was deemed by the Service to occur only if it was a point of view not prevailing at the time (i.e., was minority view) and this is evidenced by the granting exemption to charitable and educational organizations which promoted involvement in World War I (S 992 1 Cum. Bull. 145, 1919) and for persons who argued for protectionism and tariffs (S 455, Aug. 28, 1918 (unpublished)).

Unpopular organizations, including those which argued for statutory authority to organize the labor movement, were deemed to be propaganda organizations and not educational. (S 1362 2 Cum. Bull. 152 (1920)).

The Internal Revenue Service, ignoring common law,[2] consistently held that charitable and educational purposes did not include even incidental activity aimed at altering the political landscape by attempts to influence legislation. The Board of Tax Appeals agreed with the Service that the concept of education or charity did not include attempts to disseminate controversial or partisan propaganda including information relating to the harm (including physical, mental, moral and spiritual) arising from indiscriminate use of alcohol. Herbert E. Fales, 9 B.T.A. 828 (1927).

The Service's successful attack on the predecessor of Planned Parenthood, the American Birth Control League, was the building block of conformity and its functional distrust of dissent. Slee v. Comm'r, 15 B.T.A. 710 (1929), aff'd 42 F.2d 184 (2d Cir. 1930).

---

[1] After 1915 in a somewhat similar fashion Regulations 33, Article 143, and T.D. 2690, 20 Treasury Decisions Internal Revenue 126, 197 (1918) also denied business deductibility to lobbying expenses. See Textile Mills Security Corp. v. Commissioner, 314 U.S. 326 (1941).

[2] See cases collected in "The Taxation of Ideology", XIX Cath. Univ. L.R. 50 (Fall, 1969). "We are led to conclude that a trust for a public charity is not invalid merely because it contemplates the procuring of such changes in existing laws as the donor deems beneficial to the people in general, or to a class for whose benefit the trust is created. To hold [otherwise] . . . would discourage improvement in legislation and tend to compel us to continue indefinitely to live under laws designed for an entirely different state of society. Such view is opposed to every principle of our government based on the theory that it is a government 'of the people, by the people, and for the people,' and fails to recognize the right of those who make the laws to change them at their pleasure, when circumstances may seem to require." Taylor v. Hoag, 116 Atl. 826 (Pa. 1922).

Again manifesting its desire to assist partisan organizations where the partisanship represented the status quo, the Internal Revenue Service ruled favorably on an educational organization that was to awaken public sentiment on the need to rehabilitate convicts, I.T. 2088, Cum. Bull. III-2, 220 (1924), an organization to establish a favorable climate for improving the efficiency of the Army, S. 992, Cum. Bull. No. 1, 145 (1919) and organizations which encouraged young people to join military service camps, GCM 11705, XII-1, Cum. Bull. 57 (1933). Likewise, organizations which were intended to promote the full and free use of guns were also treated as charitable and educational. GCM 443, V-2, Cum. Bull. 66 (1926). If the organization was involved in influencing legislation, it could be educational if the topic of the legislation was favored by the Internal Revenue Service, such as helping Indians (GCM 3830, Cum. Bull. VII-1, 114 (1928)), or fish and game preserves (I.T. 2546, Cum. Bull. IX-2, 122 (1930)). But if the legislative activity involved alcohol prohibitions (O.D. 704, Cum. Bull. No. 3, 240 (1920)) or labor law reforms (S. 1362, Cum. Bull. No. 2, 152 (1920)), the applicant was deemed too partisan and too controversial to be exempt.

II.

CONGRESSIONAL ACTIVITIES

Congress was equally ill suited to recognize the desirability of having full, free and fair presentation of differing viewpoints through the tax exempt sector.

1. The 1934 change in the statute was obviously directed to the National Economy League, a conservative organization which acted in a hostile fashion to the then evident desires of those who favored the Administration's "New Deal." Senator Reed, of the Finance Committee, explained that he wanted committee staff to draw an anti-legislation amendment affecting charitable and educational organizations which would have the effect of stripping the National Economy League of its tax exempt status but not do the same thing to the Society for the Prevention of Cruelty to Children, both of which engaged in legislative activity. He stated that he did not want the committee to affect a "worthy institution" but "there is no reason in the world why a contribution made to the National Economy League should be deductible * * *." 78 Cong. Rec. 5861, 7831 (1934). On July 25, 1934, less than three months after the effective date of the Revenue Act of 1934, the private letter ruling to the National Economy League was revoked by the Internal Revenue Service. Thurman Arnold, in his book, "The Folklore of Capitalism", devoted an entire chapter to the business and affairs of this organization during the Great Depression. It stood for everything F.D.R. opposed and it was sacrificed as being unworthy of exemption. Congress continued its attack on organizations which were controversial by alleging that certain organizations were "subversive" and as such were not entitled to tax exempt status including organizations which were alleged to be

be "Communist controlled." See 88 Cong. Rec. 7441-58 (1942). See also Estate of Marshall v. Commissioner, 2 T.C. 1048 (1943), aff'd 147 F.2d 75. This same "anti-pink" attack by Congress against organizations which were deemed subversive led the Internal Revenue Service to challenge the tax exempt status of a radio station (WEVD) which was organized to promote the "dissemination of liberal and progressive social views." The Second Circuit, declined to follow the Slee decision and affirmed the tax exempt status of the organization in Debs Memorial Radio Fund, Inc. v. Commissioner, 148 F.2d 948 (2d Cir. 1945), reversing 3 T.C. 949 (1944).

During this controversy over allegedly nondemocratic charitable and educational organizations, the Internal Revenue Service reaffirmed its views that dissident organizations were not entitled to be treated as charitable or educational:

> "The publication of books and the giving of lectures advocating a cause of a controversial nature shall not of itself be sufficient to deny an organization the exemption, if carrying on propaganda, or otherwise attempting to influence legislation form no substantial part of its activities, its principal purpose and substantially all of its activities being clearly of a nonpartisan, noncontroversial and educational nature." Sec. 101(6-1), Regs. 101, Revenue Act of 1938, dated February 19, 1939.

In response to Congressional demands, the Internal Revenue Service indicated that "The tax laws do not contemplate and it has never been our policy to grant tax exemption or other privileges to subversive organizations." IRS Press Release, 1948 CCH Income Tax Service ¶6075. Further Congressional action was taken by imposing, under the Internal Revenue Code, a condition of exemption pursuant to provisions contained in the Subversive Activities Control Act of 1950. That law provided that any organization required by a final order of the Subversive Activities Control Board to register as a Communist group was not entitled to tax exemption. This particular provision, 501(n), remains in the Code despite the fact the Subversive Activities Control Board was abolished in 1970.

The Congress attempted further intimidation of the exempt organizations community by holding a hearing on the Institute of Pacific Relations on July 25, 1951 which lasted intermittently through June 20, 1952. A report was issued (Senate Committee on Judiciary, S. Rep. 2050, 82d Cong. 2d Sess. (1952) which claimed that IPR was an instrument of Communist propaganda and military intelligence. The Internal Revenue Service, acting on that Congressional report retroactively revoked IPR's tax exempt status. Five years later, a federal district court held that IPR was exempt as a charitable and educational organization. Institute of Pacific Relations v. United States, 5 AFTR 2d 1333 (S.D.N.Y. 1960).

From 1952 to 1954, Congress in a very determined fashion, investigated private foundations to measure their subversive tendencies and at that time, evoked statements from the Internal Revenue Service that it was not their "practice" to allow subversive organizations to be tax exempt. The Internal Revenue Service did not define at that time nor has it since then, determined or exemplified what constituted a "subversive" organization. See, e.g., Hearings Before House Select Committee to Investigate Tax Exempt Foundations and Comparable Organizations, 82d Cong, 2d Sess 61 (1952); see also, H. Rep. 2514, 82d Cong, 2d Sess (1952).

Again, individual members of Congress sought to deny tax exempt status to exempt organizations which were in undefined fashion "subversive." Senator McCarren, during the course of the consideration of the Internal Revenue Code of 1954, attempted to legislate around the final order provision of Section 11(b) of the Subversive Activities Control Act. His attempted amendment at the Internal Revenue Code of 1954 would have made a mere listing on the Attorney General's list grounds for loss of tax exemption. See 100 Cong. Rec. 9038-9039 (1954).

During the same time, Senator Lyndon Johnson was facing a difficult re-election campaign, strongly opposed by H.L. Hunt and his Lifeline Foundation. Based on a floor amendment by Senator Johnson, a 501(c)(3) organization which intervened in a political campaign would lose its tax exempt status. Lyndon Johnson's naked statement may be found as Amendment 102(a), July 2, 1954, 100 Cong. Rec. 9604, 11461.3/

In 1964, Senator Harry Byrd, the then Chairman of the Finance Committee sought to have the Internal Revenue Service take away the tax exempt status of the National Council of Churches for its efforts in support of the Civil Rights Act of 1964. The Internal Revenue Service did, in fact, audit the National Council of Churches but declined the Senator's invitation to revoke its tax exempt status under the then existing law. 110 Cong. Rec. 5078 (1964).

III.
RECOMMENDATIONS

It is obvious that from this brief exemplification of the fairly constant and generally unfavorable attempts by both the Internal Revenue Service and the Congress to use the tax system to create additional burdens for organizations which are not in the mainstream of current political thought, that the American public has been ill-served by the limitation on lobbying. There is no obvious tax policy reason which supports the continued

---

3/ The amendment was obviously political since it was not handled by the tax staff -- it was not until the 1969 Reform Act that a comparable campaign limit was added to the charitable deduction provisions.

denial of exemption to organizations which engage in substantial legislative activity. It is appropriate to increase, in light of current circumstances, all forms of public debate over topical matters of concern to the legislature or under consideration by it. The public, through the various institutions it supports with its funds, should be encouraged to participate in large measure with their money through the incentives given to contributions to tax deductible organizations. For in all likelihood, persons will follow their pocketbook and add to the institutional voice their own personal actions enlarging the debate, extending the record and having a more informed, a deeper felt, and a more stimulating debate on public affairs through the enhancement of the role of public institutions.

Mr. **Anthony**. Mr. Lehrfeld, thank you very much for the testimony.

Next we will hear from Mr. Silverstein.

STATEMENT OF LEONARD L. SILVERSTEIN, SILVERSTEIN & MULLENS, WASHINGTON, DC

Mr. **Silverstein**. Thank you, Mr. Chairman.

First of all, let me say, as my panelists here have just noted, I have no doubt that the vast majority of the tax-exempt organizations of the country are performing well within acceptable boundaries of behavior.

Nevertheless, I believe that there is a time—and that has arrived—for additional changes; that is, an evolution of the legislative process. I believe also, first, that there ought to be a more level playing field in terms of the distinctions and the treatment of the different types of 501(c)(3) entities, and as has been noted earlier by Secretary Mentz, I believe that there should be a more effective statutory mechanism for monitoring public charities, and finally, that the Service should—and the Treasury, too—should have more resources. And my thought here is that there ought to be a dedicated portion of the Department and the Service devoted to this entity, these entities and this sector of society.

We hear from Chairman Pickle that no one knows, in quotes, what is going on in the area. We've heard also that there are approximately $300 billion in the area, and we have the anecdotes of abuses.

My suggestion here, which I have to put on a flak jacket, I believe, to make, would be to consider the application of a 1 percent audit fee tax to tax-exempts. At the moment, only private foundations are subject to this tax. I see no reason for singling out private foundations. If there are resources needed and there are budgetary problems in a minimum tax area, then one way is to extend that to the full range of tax-exempt organizations, or if it's believed that the Government can do this without the additional audit fee tax, then certainly the time has come to drop the tax on private foundations.

I also believe the same with respect to the distinction between public charities and private foundations, the latter, since 1969, having been denied the right to engage in any lobbying. It seems to me we should have a level playing field with respect to those charities who are entitled—those entities that can receive tax-deducted funds—private foundations, (c)(3) entities, and some business entities.

For this reason, I suggest that you—this committee—consider the elimination of the right for grassroots lobbying by public charities and make them on a level with private foundations. I believe much of the problems that has reached this committee's attention today would be solved if that would occur. I realize that there are problems of allocation between (c)(3)'s and (c)(4)'s and (c)(6)'s.

On the other hand, those problems have to be dealt with in any event, and with this distinction, I think much salutary benefit would result.

I would make one other point, and that is, I believe the conversion from a private foundation to a public charity is not adequately dealt with in the code today. It's too easy to receive or generate public support, and with the use of sophisticated mailing techniques to which reference has been made earlier today, one can generate a public charity free of much of the rules which apply to private foundations, run by a small group of what I'll loosely say, "promoters," with no direct linkage between the governing body and the entity itself.

It seems to me that some consideration should be given to modification of those rules, and no doubt, if chapter 42 applies to taxable expenditures, including improper political activities for public charities, that problem would be moderated, but would nevertheless be present.

In summary, I would say, consider limiting the grassroots lobbying privilege to take that to charities who don't receive tax deduction for contributions and other entities; to have a much—apply chapter 42 to public charities; and finally, consider an audit fee tax with loose application in the sense that universities, and other established institutions, would not be subject to the tax. It could apply only to those entities that have an excess of receipts over expenditures, and there could be a threshold of some statutory number that would exonerate the many thousands of very small entities.

Given the power of anecdotes, in conclusion, it seems to me that the following ought to be noted to this committee. In 1969, the same problem arose that we face today with respect to private foundations: Congressman John Rooney of New York found that in the course of his reelection campaign, certain of his constituencies were receiving charitable grants—that is, entities involving his constituency—were receiving charitable grants, and it turned out that the grantor was a foundation controlled by his opponent. He said to this committee on February 19, 1969—

> I'm the first known Member of Congress to be forced to campaign for reelection against the awesome financial resources of a tax-exempt foundation.

Well, he may have been the first known Member, but I don't think, as today's hearings have demonstrated, he has been the last Member. And hopefully anecdotes like this, sometimes idiosyncratic in their impact, nevertheless stir up what I believe is a very healthy examination process.

Thank you.

[The prepared statement and a letter received subsequent to the hearing follow:]

STATEMENT OF LEONARD L. SILVERSTEIN, SILVERSTEIN & MULLENS

Chairman Pickle and members of the Subcommittee:

My name is Leonard L. Silverstein. I am a partner in the Washington law firm of Silverstein and Mullens.

I am pleased to respond to the Subcommittee's invitation to present views respecting the propriety of current law and administration of tax-exempt organizations which engage in lobbying and political activities. Although this subject is hardly a new one, it retains its vitality particularly as specific anecdotes arise of excessive, and doubtless improper, section 501(c)(3) involvement in political activities. In the remarks which follow, I will refer to section 501(c)(3) charities as those entities described in that provision to which deductible contributions may be made and to "section 501(c) entities" as other nonprofit entities identified in section 501(c) but to which deductible contributions may not be made.

The baseline of legislative interest in this field may be traceable to Justice Learned Hand's opinion of the American Birth Control League, 42 F.2d 184 (1929), in which it was held that contributors to a section 501(c)(3) charity were not deductible, since the political activities of that organization prevented it from operating "exclusively" for charitable purposes.

His celebrated quotation bears repeating here:

> "Political agitation as such is outside the statute, however innocent the aim...Controversies of that sort must be conducted without public subvention; the Treasury stands aside from them."

To a limited but meaningful extent, Justice Hand's admonition was taken into account by the Congress during consideration of the Internal Revenue Code of 1954 when, during the course of the Senate floor debate on the measure, the then Texas Senator Lyndon B. Johnson caused to be added to section 501(c)(3) an amendment which prevents the grant of section 501(c)(3) status to an organization which "participate[s] in, or "intervene[s] in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office." Although not immediately evident from the legislative history, it is entirely possible that his concerns arose because of a specific event (in light of political climate of the times) or as a result of Lyndon B. Johnson's general political acuity.[1] In 1962, Congress

---

[1] The Johnson amendment was adopted by the Senate on July 2, 1954, a mere day after Senator McCarran had introduced a similar but much harsher amendment that would have revoked the exempt status of organizations making donations to "subversive"

(Footnote continued on next page)

authorized business deductions for direct, but not grass roots, expenditures by business organizations, and in 1976 permitted section 501(c)(3) charities an elective but limited allowance for both direct and grass roots lobbying.

On the other hand, the 1969 Congress was made aware of an anecdote involving egregious election campaign activities by a private foundation, and reacted quite differently by vigorously enacting Chapter 42 of the Code.

In this connection, I am sure that you will find the testimony of Congressman John Rooney--the then victim of the political activities of the offending private foundation and its chief contributor--as meaningful today as it was on February 19, 1969, when he stated to this Committee:

> "I am the first known Member of Congress to be forced to campaign for reelection against the awesome financial resources of a tax-exempt foundation."

The Congressional response to this and other private foundation abuses alleged to exist in the 1960's was the addition to the Code of Chapter 42. Pursuant to this Chapter, private foundations were precluded not only from involving themselves in any lobbying activities whatsoever, inter alia,[2] but also were made subject to an elaborate tax-regulatory scheme which affects virtually every aspect of a private foundation's operation as well as the acts of its governing body. The Chapter 42 pattern was devised to assure that the statutory constraints on conduct would be both meaningful and effectively self-operative. While Chapter 42 was regarded as a punitive measure at the time, its enactment was justified on the grounds that private foundations represent tax deductible aggregations of wealth under the control and domination of a small group of persons, or even the "incorporated pocketbook" of just one person. In these circumstances tight self-operative controls were viewed to be an appropriate counter measure.

In sharp contrast, however, no sanctions comparable to Chapter 42 were or are imposed on section 501(c)(3) charities which avoid private foundation status by reason of broad based public support. Experience with Chapter 42 since 1969 indicates that not only have the policy objectives of Chapter 42 been achieved, but, from the standpoint of the Internal Revenue Service, this has occurred within a satisfactory administrative framework:

> "Far from being too harsh or burdensome, we believe the private foundation tax rules are actually beneficial to the charities that are governed by those

---

(Footnote continued from previous page) organizations or individuals (100 Cong. Rec. 9446 (July 1, 1954)). A close reading of the Congressional Record of that week would seem to imply that anti-communist sentiment was high-pitched at the time, prompted especially by discussion of the proposed admission of Communist China to the United Nations, as well as of left-wing subversive activities in Guatemala. The Johnson amendment may very well have been an attempt to pacify Senator McCarran and his like without exposing tax-exempts to IRS-conducted witch hunts of potentially devastating dimensions.

[2] Yet significantly, this prohibition does not extend to nonpartisan analysis or research. See, section 4945(e) I.R.C. (1986).

> restrictions...Although the initial implementation of the Act was exceptionally challenging, we believe that this law is now relatively clear, fair, and straightforward to administer. Through the development of rulings, taxpayer education materials, and our audit presence, we attempt to administer the law fairly and evenly." ("Tax Rules Governing Private Foundations," Hearings Before the Subcommittee on Oversight of the Committee on Ways and Means, House of Representatives, 98th Congress, 1st session, p. 65 (June, 1983))

In the foregoing light, I suggest that this Subcommittee can very usefully draw upon these past experiences in resolving the issues which you confront today.[3]

---

[3] Consideration also may be given to the validity of the statutory dichotomy--based upon the presence or absence of so-called public support between private foundations and public charities. Upon satisfaction, under section 509 of the Code, of the public support test (which includes membership fees as well as business receipts in addition to contributions) a nonprofit organization and its managers are free from federal government sanctions for improper conduct except through total withdrawal of exempt status. Two observations may be made respecting this dichotomy. In the first place, it appears from my own anecdotal experience at least, that private foundations have comfortably adjusted to the various constraints imposed by Chapter 42. While it also appears that the birth rate of new private foundation information has declined somewhat, many very large private foundations, often created by bequest since 1969, such as the Getty and MacArthur Foundations, have now come into existence. Secondly, a threshold issue exists concerning the question of whether the presence of public support is in the real world an appropriate means of differentiating between those exempt organizations which should be subject to self-operative constraints (such as Chapter 42) and those section 501(c)(3) so-called public charities, which should be free of such rules. Certainly in the case most established universities, hospitals, museums, or other comparable institutions with representative regional, local, and national boards to monitor governance, there has been no indication of significant improper conduct in political activity fields or, were such conduct to come to light, of the lack of capacity of the governing body to rectify the problem. A different situation is presented, however, between those organizations, and other categories of entities which may operate in other public policy fields. Organizations operating in these areas can generate "public support" through the use of sophisticated media or direct mailing techniques to create a "membership" even though no substantial affiliation or linkage exists between the governing body and diverse and distant membership. In those cases, important and ongoing financial support can be generated by emotionally based appeals to selected sectors of the general public. The success of appeals of this nature is materially enhanced, of course, if the solicited donor is made aware that his contribution is "tax deductible." The governing body, meanwhile, which may be completely unknown to the contributors, is totally free to reign without any effective accountability to the organization, or for that matter, to the public, unless and until the Internal Revenue Service audits the entity. It is also a curiosity that a private foundation, in certain instances, can avoid Chapter 42 limits through the inauguration of an aggressive mail order campaign to a carefully selected public thereby freeing itself from the private foundation tax and the other limitations of Chapter 42.

In summary, I believe that the important reasons for the concerns which now beset this Subcommittee stem from lack of: 1) a more level playing field with respect to private foundations, other section 501(c)(3) public charities, as well as to other tax-exempts; 2) a more effective statutory mechanism for monitoring the activities of certain section 501(c)(3) entities, consistent with the opportunity to receive tax deductible contributions; and 3) adequate resources to enable the Treasury Department and the Internal Revenue Service to develop information for the government and the public respecting operation of the nonprofit sector.

More specifically, the following is suggested:

1. Reduction in the disparity treatment of section 501(c) organizations.

Of the 842,000 organizations which are exempt under section 501(c) of the Code, approximately 371,000, or 44 percent, qualify under section 501(c)(3). Of this number, only 370,000, or approximately 10 percent, constitute private foundations.[4] The remaining 334,000 section 501(c)(3) organizations are not only exonerated from federal income tax (except with respect to unrelated business income) but they also enjoy the added privilege of receiving contributions which are deductible (within the Code's limits) from the donor's taxes. Obviously, the factor of deductibility is often a key element in the securing of support, and to that extent accords section 501(c)(3) organizations a major solicitation advantage in relation to other categories of section 501(c) tax-exempts. Particularly this is the case respecting civic leagues, exempt under section 501(c)(4), and trade associations exempt under section 501(c)(6), since these entities also involve themselves heavily in matters of public policy.[5]

Further, and also in contrast to private foundations and business organizations which can receive tax deductible funds, a section 501(c)(3) organization can engage in grass roots lobbying so long as the amounts expended do not exceed either the "substantial part" test or the elective limits provided under section 501(h). And in the case of the many large public charities, it is evident that substantial sums can be expended annually through membership drives thereby creating a "substantial part" safe harbor to shelter large amounts of tax-deducted financial support for grass roots lobbying purposes. This, I suggest, distorts both the tax and political process. It unfairly multiplies the public appeals of the charities whose legislative interests coincide with qualification under section 501(c)(3) and it may, in fact, induce the formation of such entities for the principal purpose of attracting funds rather than for the genuine resolving of public issues. I accordingly suggest that consideration be given to withdrawal of grass roots lobbying privileges from section 501(c)(3) entities. On the other hand, and although commentary respecting proposed regulations distinguishing between direct and grass roots lobbying is beyond the scope of this hearing, if the instant proposal is considered to be meritorious, this Subcommittee may wish to consider more detailed and somewhat more liberalized articulation of acceptable boundaries between direct and grass roots lobbying. These would then be applied in a uniform manner to private foundations, section 501(c)(3) charities, and business organizations, leaving the greater latitude of grass roots lobbying to section 501(c)(3) entities which do not benefit from tax deducted contributions.

---

[4] The penalties of section 4911 which apply to certain lobbying activities of section 501(c)(3) organizations are elective. See, section 501(h), IRC (1986).

[5] Dues paid by a taxpayer to a trade organization of which he is a member are deductible if expended for lobbying and communicating information between the organization and the member, only to the extent if paid or incurred with respect to legislation of "direct interest" to the association or its members. (I.R.C. section 162(e)(1) and (2); Reg. section 1.162-20(c)(3). The proposed Regs. section 1.162-20 would introduce a 3-factor test so as to verify whether a communication constitutes an attempt to influence the public with respect to legislation. Only those communications 1) pertaining to "action by a legislative body," 2) reflecting "a view on that legislative action, whether explicitly or implicitly," and 3) distributed "in a manner so as to reach individuals as voters or constituents" would qualify. The proposed Regulations furthermore would limit deductions for dues or other payments if the recipient organization engages in any activities within the scope of section 162(e)(2), whether or not those activities constitute a substantial part of the organization's overall activities.

2. New Rules for Governance

In my view the issues which we address today would not have arisen had the Internal Revenue Service been afforded more effective statutory and administrative tools.

Indeed, under the present law in the case of a section 501(c)(3) public charity, rules respecting accountability of its governing body (including those who participate in inappropriate political activities) are left to the Attorneys' General of the states, whose involvement in the field varies from jurisdiction to jurisdiction and is often nonexistent.

In the case of the Federal Government, remedies are limited to the denial of tax deductibility and tax-exemption status, with penalties as a function of an audit lottery process which is principally directed at the organization and not also its management.

As we approach this problem, this Subcommittee may wish to consider the application to section 501(c)(3) entities of certain provisions of Chapter 42. Similar problems--for similar reasons--were considered by the Filer Commission on Private Philanthropy and Public Needs and in my view that Commission's recommendations very much merit this Subcommittee's attention. These include:

a) Application to section 501(c)(3) entities of provisions comparable to section 4945 taxing expenditures for acts, including improper lobbying, which extend beyond the purposes of the entity. Excise penalties would be imposed both upon the entity and those members of its governing body who actually participated in the improper acts.

b) The establishment within the Internal Revenue Service of an appeals procedure to respond to objections to imposition of penalties. Notwithstanding the Service's exemplary administration of Chapter 42, the activation of such an appeals body may serve to allay concerns of overreaction.

c) Empowering of the Justice Department, at the instance of the Service and the Treasury, to seek violations of statutory or administrative provisions.

To avoid excessive administrative involvement, certain categories of entities of small size or special character could be wholly or partly excluded from these provisions. On the other hand, organizations which, it is suggested, may appropriately be subject to these rules would include those which depend upon widespread mailing and media--often scare--campaigns to develop and maintain membership and with respect to which no real ties exist between the supporting membership and the governing body (whose objectives many times are best served by the fostering of a bureaucracy rather than through the promotion of the stated charitable goals of the organization).

3. Increased reporting and one percent audit fee tax.

As a complementary procedure to the foregoing, the Treasury and Internal Revenue Service staff devoted to tax-exempt entities should be augmented. While the present Form 990 required of all section 501(c)(3) organizations requires the production of substantial information, the extent to which data respecting governance and operation (including both direct and grass roots lobbying activities) is made available to the Service is not clear. The situation can be rectified, partly through the required submission of more information to the Internal Revenue Service, and possibly through an augmented national office and field staff whose duties would include enhanced compliance functions.

As a final suggestion, consideration may be given to the imposition of a one percent audit fee tax on all tax-exempt organizations. Such a fee could be measured by reference to net investment income, if any, or to the excess of receipts over expenditures, so that "loss" charities would not be affected. Exceptions could also be made for small organizations with gross receipts below a statutorily denominated threshold, as well as certain categories of institutions--universities, for example, could be excluded from the taxable category. I make this proposal, because I find it difficult to accept the fact that, as of 1987, in light of circumstances which bring us here today, private foundations alone should be subject to levy to compensate the government for its monitoring of the tax-exemption process. More adequate resources will also enable the Treasury Department to develop reliable statistics not only respecting political activities on nonprofit organizations but, with equal importance, respecting the operational dimensions of the nonprofit sector.

To allegations, which may be anticipated, that collection of the tax will deprive the nonprofit sector of an equivalent amount of contributed funds, it is fair, in my judgment, to respond that a very modest charge is fair consideration for operation of the tax-deduction and tax-exemption privileges in an era of minimum tax and revenue concerns. To the response that the tax, once imposed, will rise over time, one can review the history of the Chapter 42 tax. Originally set at four percent, this percentage has been progressively reduced to its present level, as the result, I might add, of direct--and, in my view, appropriate--lobbying by the private foundation community.

As a final comment: There is little doubt that the vast majority of tax-exempt entities operate entirely within the boundaries of acceptable behavior. Further, it is also likely that any suggestions, such as the instant ones, which move from the status quo, or which can be construed to impose limits on total freedom of operation will engender opposition on grounds of burdensome bureaucratic "red tape" or interference with freedom of expression. The suggestions contained herein are designed, in fact, to protect values conducive to a vigorous and vital nonprofit sector, and to assure, in the long run, that the public may more fully appreciate and benefit from the unique contributions which the sector makes to the quality of life in America.

###

LAW OFFICES
SILVERSTEIN AND MULLENS
1776 K STREET, NORTHWEST
WASHINGTON, D.C. 20006
(202) 452-7900

LEONARD L. SILVERSTEIN
RICHARD A. MULLENS
GERALD H. SHERMAN
~~ROBERT E. FALB~~
JERRY J. McCOY
ADELBERT L. SUWALSKY, JR.
STUART M. LEWIS
~~RONALD D. ABRAMSON~~
LYNN K. PEARLE
JOHN P. WARNER
ROBERT E. LILES, II
BAROYL R. TIRANA
DONALD B. REYNOLDS, JR.
CHARLES E. TAYLOR
DIANE J. FUCHS
~~[illegible]~~

HARRISON B. McCAWLEY
JAVED A. KHOKHAR
DONALD J. MATHISON
~~PATRICIA R. LESSER~~
PATRICK G. DOOHER
~~DEBORAH M. BEERS~~
JAMES F. MILLER
JOHN FREEMAN BLAKE
SAMUEL M. MA[illegible]CA
JOHN F. LEFEVERE*
JANE M. ELDREDGE
TA[illegible] E. EDLUND
GEORGE B. DELTA*
LUCIA N. SMEAL
MARILYN E. NELSON*
~~[illegible]~~

*NOT ADMITTED IN D.C.

EDWARD L. MERRIGAN
COUNSEL

CABLE "SIMUL WSH"
TELEX: 64426
TELECOPIER: (202) 452-7989

WRITER'S DIRECT DIAL NUMBER
(202)452-7920

March 17, 1987

The Honorable
J.J. Pickle
Chairman
Subcommittee on Oversight
House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

This letter is an addendum to my testimony delivered before your Committee on March 12. A brief review of the General Accounting Office's report on "Competition Between Taxable Businesses and Tax-Exempt Organizations" includes the statement (p.1) that "...Overall, we found that complete data do not exist to quantify the nature, extent, and impact of competition between these two [business and tax-exempt] communities." This factor is all the more evident when it becomes apparent in the review of the report much of the data which was utilized for study is based upon 1975 activities.

I personally found the concerns which your Subcommittee has addressed and will address to be most useful, not only to the taxable and tax-exempt communities but to the general public. And, notwithstanding that "IRS officials recognize that better data are needed...and have initiatives planned or underway to develop better data" (p.21), I question whether this will occur unless, as noted in my testimony, personnel and organizational adjustments

The Honorable J.J. Pickle
March 17, 1987
Page two

are dedicated to this task, both within the IRS and (perhaps the Office of Tax Analysis) at Treasury. In the course of the questioning at the hearing a suggestion was made that a flat fee (a moderate amount ($250)) payable by tax-exempt organizations would generate $80 million per annum. This is certainly an approach which merits consideration, since in my view, even if the good efforts of your Subcommittee ultimately eventuate in legislation, the beneficial consequences will be diluted in the absence of an ongoing monitoring and information dissemination process.

Sincerely,

SILVERSTEIN AND MULLENS

Leonard L. Silverstein

LLS/ssd

Chairman PICKLE. I thank you. I had to be out of the committee room for a time, and haven't heard all the witnesses.

Let me ask each one of you, even though it may be a repetition, I'd just like to know, Mr. Jones, do you represent the American Bar Association in this testimony?

Mr. JONES. The American Bar Association has not had an opportunity to meet and consider the testimony under our procedures. I'm authorized to speak for the Section of Taxation of the American Bar Association; I offer my testimony in that capacity.

Chairman PICKLE. You're not representing any group or organization.

Mr. JONES. The Section of Taxation is the tax lawyers who belong to the American Bar Association, some 30,000.

Chairman PICKLE. Well, do you or your firm represent tax-exempt organizations, is that your specialty, or who do you represent in your firm if you're representing tax-exempt organizations?

Mr. JONES. I don't—I don't personally represent—well, maybe one tax-exempt organization in a different field here.

Chairman PICKLE. All right.

Mr. JONES. I'm speaking here as representative of the Bar Association, Section of Taxation rather than my private capacity.

Chairman PICKLE. Has your section met and agreed to make the statement that you have submitted to us, is that their statement by approval?

Mr. JONES. When it comes up on short notice like this, the procedure is that it is circulated to our council which is a governing body of some 20, who then review it and approve it for submission. Before it's submitted, a copy is sent to all the other sections of the American Bar Association. And if they objected, we would not be permitted to speak.

Chairman PICKLE. Well, I take it that in essence you're saying that you, in general, oppose further restrictions?

Mr. JONES. No. That's not the intent of my statement. I said, one should move carefully to avoid imposing a burden on the overwhelming bulk of these associations, which do act responsibly. No. I don't think that's a fair inference, sir.

Chairman PICKLE. Well——

Mr. JONES. If I left that inference, I withdraw it.

Chairman PICKLE. You said, we should proceed carefully, and I accept that.

Mr. Lehrfeld——

Mr. LEHRFELD. Yes.

Chairman PICKLE. I assume that you said that these organizations should have unlimited right to lobby. Is that essentially correct?

Mr. LEHRFELD. Yes. That's what my recommendation would be, to repel the 1934 limitation, and the 1976 rules, so there could be a fuller, fairer, freer debate in the public sector about topical issues, that's correct.

And by the way, Mr. Chairman, I have a copy of the 1972 comments of the American Bar Association which were submitted as the American Bar Association recommendations to the Ways and Means Committee when it took up H.R. 13750, which was the predecessor to the 1976 amendments. And I would be happy to supply a copy of this for the record.

Chairman PICKLE. The committee would be glad to have them. You say that the comments were made in 1972?

Mr. LEHRFELD. Yes. This was an ABA-approved position, in 1969, not just the Tax Section. At that time, the ABA House of Delegates voted that the 1934 law be liberalized, so that charities could engage in an unlimited amount of direct lobbying on matters of direct interest to them.

Chairman PICKLE. Now, on the other hand, Mr. Silverstein is, in a sense, proposing tighter restrictions, particularly the same as those applied to private foundations.

Mr. SILVERSTEIN. Well, yes. I think there's a very clear dichotomy that can and should be drawn between those organizations that receive tax deductible funds and those that though exempt at the corporate—at the organization level—receive nondeductible contributions. There is a problem of allocation, and I think you're addressing and should address this. But once you make that determination, at that point it seems to me, those organizations that can induce tax-deducted contributions should not be able to go to the public for grassroots lobbying in the same sense that political organizations or other tax-exempts such as (c)(4)'s can.

Chairman PICKLE. Well, can the Internal Revenue Service today, adequately monitor and enforce the current law restrictions on lobbying the political activities. Are more resources needed? Do you need better reporting under the 990? Do we need more auditing down at the IRS?

Mr. SILVERSTEIN. I'm not clear why the Service feels they have adequate resources, whether a five percent level of review is sufficient, given the 800,000 entities. It doesn't appear to me to be sufficient. On the one hand, there is the sensitive issue of not interfering with the privacy of persons or the privacy of the organizations. But on the other hand, there is the amorphous nature of the entire nonprofit section. You said that yourself, Mr. Chairman, earlier, as you opened the meeting, when you noted the reason we continue to wonder what tax-exempt organizations are doing is in part because no one knows what they're doing.

Now, it seems to me the time has arrived to do something about that. That's why, as a suggestion, dedicate officially, so that there isn't a resource problem, through some sort of audit tax. And it seems to me that would not be burdensome, if carefully structured, and it would assure then that you would have budgetary resources to deal with this problem as insurance.

Chairman PICKLE. I beg your pardon. Do any other panelists want to comment on this thing or these things?

Mr. LEHRFELD. I would observe that your colleague, Hal Daub, introduced a bill in 1984, H.R. 6388, which expressly did this for the exempt organizations area, suggesting an audit fee tax of up to $250 per return, per form 990, be charged together with a separate filing fee for rulings, such as that which is imposed by the Securities and Exchange Commission on their filings.

When you ask for a ruling request, whether by exemption application or otherwise, you would pay a filing fee. The revenue estimates by the Joint Committee indicated that upward of $80 million could be raised from these two fees.

In addition, President Reagan in three, I think, of the five budgets he submitted to the Congress, specifically mentioned imposing user fees on the rulings process as a means of raising funds for enforcement purposes.

Chairman **Pickle**. Yes, I'm mindful of that recommendation.

Do any of you other gentleman want to comment?

Mr. **Jones**. The ABA does have a position. In support of funding for the Internal Revenue Service we have been working, and that is an ABA position. We've been working very closely; its been very well supported by Congress.

My concern is simply that, because of this focus over the last three years, there's been a very large increase in personnel. Frankly, I think if you added any more, there might be some question as to whether the IRS could make efficient use of them.

I would like to give Commissioner Gibbs a chance, as he said, to use a special focus before we throw more money at that. I think it can be handled.

Mr. Chairman, Mr. Lehrfeld says that I'm inconsistent with the 1972 ABA position. I'm satisfied that I'm not. I don't want to take the committee's time, but I wonder if I can submit a letter on that for the record.

[The following was subsequently received:]

American Bar Association,
Section of Taxation,
Washington DC, March 13, 1987.

Hon. J.J. Pickle,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, Longworth House Office Building, Washington, DC.

Dear Congressman Pickle: At the hearings yesterday William Lehrfeld, a copanelist, stated that the position I presented on behalf of the Section of Taxation was contrary to a 1972 position of the American Bar Association. There is no basis for such a comment.

In 1969, the American Bar Association on the recommendation of the Section of Taxation, adopted a recommendation that tax-exempt organizations not be restricted from lobbying when Congress was addressing issues that affected the organization itself. In 1976, Congress agreed with that recommendation and enacted Section 4911(d)(2)(C) excluding such activity from the definition of "influencing legislation." In 1977, the recommendation was formally withdrawn since it had been substantially enacted in the Tax Reform Act of 1976.

Nothing in my testimony or written statement was in any way contrary to the letter or spirit of Section 4911(d)(2)(C). I did not wish to use precious hearing time to argue with Mr. Lehrfeld. I do request that this correction be placed at the appropriate place in the transcript.

Sincerely yours,

John B. Jones, Jr., *Chair.*

Chairman **Pickle**. Well, we will be waiting Commissioner Gibbs comments on that. I think we should hear from him first, and naturally we will do that.

Let me just ask one other question of you, Mr. Silverstein, because I look at the panel and one of you pretty much says that we shouldn't have further restrictions or very little, and another says that organizations should have unlimited lobbying activities.

Mr. Silverstein, you're the only one who is speaking out on the need to eliminate grassroots lobbying.

Mr. **Silverstein**. I have my bulletproof vest on, Mr. Chairman.

Chairman PICKLE. Well, at least today you're the one speaking out against it. So, I wonder if you can tell me, even extemporaneously, what is going on out there in the real world in the field of lobbying, grassroots lobbying? What is taking place? Can you give us an example of why you think that this should be curtailed?

Mr. SILVERSTEIN. Well, I didn't say curtailed in the normal sense. I don't know what's going on anymore than what I read in the papers, and what your colleagues have furnished me, that's point one.

I don't believe that there are adequate self-operative monitoring mechanisms. My experience, however, with private foundations has been, first, that the penalty excises which apply not only to the organization, but also to the managers, have been extraordinarily effective.

I also believe that the Internal Revenue Service has been extraordinarily efficient and fair-minded in the application of those penalties.

And I think that if they were in place—with relation to section 501(c)(3)'s—there would be an enormous constraint on irregular activities, and the public would then have the kind of assurance that they now have with private foundations; that would apply across the board to tax-exempt——

Chairman PICKLE. What do you mean, if they were in place?

Mr. SILVERSTEIN. Well, chapter 42—by that I mean, there is a provision there, section 4945, that describes so-called taxable expenditures. In the case of private foundations, it precludes those entities from doing either direct or grassroots lobbying. And apparently—and you, nevertheless, can supply nonpartisan analysis and research—it has worked very well. It seems to me that, that sort of formulation would be extremely useful for the section 501(c)(3) charities. And it hasn't proved to be as burdensome as people originally thought.

Chairman PICKLE. Well, I thank you very much. Now, I know each of you realize that we're trying to receive testimony, to get the sentiments, general feeling and/or recommendations of various groups. We appreciate you participating, and appearing to express your viewpoints and giving us the benefit of your testimony.

We've got several other witnesses. I want to thank each one of you. Do any of you want to make any additional statements at this point? Well, if not, I certainly thank you.

The next panel will be comprised of Brian O'Connell; Thomas Troyer; Harold Freeman; Mike Hudson; and Jack Moskowitz.

Gentlemen, I thank you for appearing before us today. I think we will proceed on the basis of the names I called out. Mr. Brian O'Connell is president of the Independent Sector. Mr. Thomas Troyer is counsel for Caplin & Drysdale, on behalf of the Independent Sector. Dr. Harold Freeman is director of surgery, Harlem Hospital Center, New York, appearing on behalf of the American Cancer Society. Michael Hudson, my good friend from the University of Texas and from Austin, TX. Who are you representing, Mike?

Mr. HUDSON. Mr. Chairman, I am representing myself but speaking about a number of nonprofit charities whom I represent.

Chairman Pickle. I thought you were representing an organization.

Mr. Hudson. Yes, sir, I represent several; the Children's Defense Fund, the Maternal and Child Health——

Chairman Pickle. Say that again.

Mr. Hudson. The Children's Defense Fund, a national charity; People for the American Way; the Maternal and Child Health Coalition which is a network of——

Chairman Pickle. Is there a name of an organization or just a number of organizations?

Mr. Hudson. A number, yes, sir.

Chairman Pickle. All right. And Mr. Jack Moskowitz, senior vice president of Government relations of the United Way.

I'm going to ask each one of you to summarize within the 5-minute limitation and then we will go forward with any questions. Mr. O'Connell, representing the Independent Sector, will proceed.

STATEMENT OF BRIAN O'CONNELL, PRESIDENT, INDEPENDENT SECTOR

Mr. O'Connell. Yes. Thank you, Mr. Chairman. As you can see from the testimony, the organization, Independent Sector, represents a wide variety of philanthropic and voluntary organizations ranging the spectrum of conservative and liberal, and ranging the spectrum of activities that are competitive with one another. Family planning and Catholic charities is one example.

The common denominator among these organizations is their passionate belief that voluntary initiative is a very special part of the American scene; that they represent vehicles by which citizens have an opportunity to express themselves, to pursue activities of all sorts, whether it is new dance forms, the practice of their religion, the practice of their education.

I have spent 35 years, Mr. Chairman, as a community organizer working with a very wide range of voluntary organizations including my leadership of the National Mental Health Association, the National Coalition of Voluntary Organizations, the National Council on Philanthropy and now, Independent Sector, and this experience over 35 years has taught me that among the many roles that nonprofit organizations fulfill, that advocacy is often the very best service.

It is often more effective for a group of citizens concerned about children with learning difficulties, for example, to use their limited dollars to convince the school board to provide special education opportunities for their children than to set up a separate school that might only serve 12 of those kids.

Over the years, as a community organizer, I have also learned that one of the greatest threats to the advocacy rights of nonprofit organizations is the absolutely legitimate concern of Congress, embodied by this committee today, and by the IRS when exempt organizations violate the law by engaging in illegal partisan political activity.

On the basis of that experience and in keeping with the candor I have always found you, Mr. Chairman, expect and respect, I would like to make three basic points. One, if organizations are transgressing current law by engaging in illegal political activity, they should be dealt with directly and harshly through enforcement of the law.

Two, if language in current law is not clear enough to legally distinguish what is obviously partisan political activity, we should isolate and address that problem without confusing or limiting the lobbying rights of such organizations.

And three, whatever changes are considered, they should not limit the rights and opportunities of voluntary organizations to be the vehicles by which citizens express their legitimate influence on public policies and services.

Let me go back to that matter of compliance and say pretty harshly and directly that if we find, for example, that nonprofit organizations participated as illegal conduits for the purchase and delivery of arms prohibited by law, and if any nonprofit organization served as a conduit for funds from the sale of arms to be used to defeat candidates who oppose support of the Contras, I am the first to condemn their actions and call for their prosecution.

And lest that be construed by anyone as partisan, I point out that in similar hearings before Congressman Brooks' committee when the issue was the Office of Management and Budget's efforts to curtail the lobbying of activist liberal organizations, I said almost exactly the same thing: "If some organizations are violating the law, they should be prosecuted."

If the committee concludes that the law is not sufficiently explicit to distinguish legitimate advocacy efforts from partisan political activity, I would welcome an opportunity to work with you to make it even clearer that organizations that are exempt and for which contributions are tax deductible must not and cannot be the vehicles for electioneering. It undermines the integrity and the credibility of nonprofit organizations if political figures set up or use exempt organizations that blatantly serve their candidacies, or if some political action committees go beyond their intended prerogatives and use 501(c)(3) entities to pursue their political ends.

My own view is that the current law is already clear enough to distinguish even these situations as compliance matters rather than amendment ones. But obviously, if it's the wisdom of this body that sharper definitions are necessary, we would welcome a chance to cooperate.

My largest concern, Mr. Chairman, my largest plea is that whatever changes are considered to deal with inappropriate interference and partisan political activity, that there be no inadvertent amendment to the appropriate and necessary advocacy functions of nonprofit organizations. Any changes that are made should underscore that partisan political activity is illegal, and therefore must be discouraged, and that advocacy and lobbying rights are legal and therefore are to be encouraged.

Thank you.

[The prepared statement follows:]

STATEMENT BY

BRIAN O'CONNELL, President
INDEPENDENT SECTOR
1828 L Street, N.W., Suite 1200B
Washington, DC 20036
(202) 223-8100

HEARINGS BEFORE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U. S. HOUSE OF REPRESENTATIVES

March 13, 1987

I am Brian O'Connell, President of INDEPENDENT SECTOR, a membership organization of 650 national organizations, foundations, and business corporations which have banded together to strengthen our national tradition of giving, volunteering and not-for-profit initiative. The range of members includes the American Heart Association, United Negro College Fund, Goodwill Industries of America, Kellogg Foundation, National Council of Churches, Native American Rights Fund, Association of Junior Leagues, CARE, Council on Foundations, American Association of Museums, Council of Jewish Federations, National Puerto Rican Coalition, National Conference of Catholic Charities, National Audubon Society, National Association of Independent Colleges and Universities, United Way of America, Brookings Institution, American Enterprise Institute, Appalachian Mountain Club, and the American Red Cross. The common denominator among this diverse mix of organizations is their shared determination that the voluntary impulse shall remain a vibrant part of America.

My 35 years as a community organizer, working with a wide range of voluntary organizations, including leading the National Mental Health Association, the Coalition of National Voluntary Organizations, National Council on Philanthropy, and now INDEPENDENT SECTOR have taught me that among the many roles that nonprofit organizations fulfill, advocacy is often their best service. It is usually more effective for a group of citizens concerned about children with learning difficulties to use their limited dollars to convince the school board to provide special education opportunities for their children than to set up a separate school that might only serve a dozen youngsters. Others on the panel will elaborate the original rationale and continuing importance of independent advocacy. In other material supplied to the Committee, I have given examples of some of INDEPENDENT SECTOR's activities that are intended to advocate and inform.

Over the years, I have also learned that one of the greatest threats to the advocacy rights of nonprofit organizations is the legitimate concern of Congress and the IRS when exempt organizations violate the law by engaging in illegal partisan political activity.

On the basis of my experience and in keeping with the candor the Chairman always requests and respects, I make three basic points:

1. If organizations are transgressing current law by engaging in illegal political activity, they should be dealt with directly and harshly through enforcement of the law.

2. If language in current law is not clear enough to legally distinguish what is obviously partisan political activity, we should isolate and address that problem without confusing or limiting the lobbying rights of such organizations.

3. Whatever changes are considered, they should not limit the rights and opportunities of voluntary organizations to be the vehicles by which citizens express their legitimate influence on public policies and services.

On the matter of compliance, if we find, for example, that nonprofit organizations participated as illegal conduits for the purchase and delivery of arms prohibited by law, and if, on the other end, any nonprofit organizations served as a conduit for funds from the sale of those arms to be used to defeat candidates who opposed support of the Contras, I would be the first to condemn their actions and call for their prosecution. Lest this be construed in any way as partisan, I point out that in similar hearings before Congressman Brooks' Committee, when the issue was the Office of Management and Budget efforts to curtail the lobbying of activist liberal groups, I said "if some organizations are violating the law, they should be prosecuted."

If the Committee concludes that the law is not sufficiently explicit to distinguish legitimate advocacy efforts from partisan political activity, I would welcome an opportunity to work with you to make it even clearer that organizations that are exempt and for which contributions are tax deductible must not and cannot be used as vehicles for electioneering. It undermines the integrity and credibility of nonprofit organizations if political figures set up or use exempt organizations that blatantly serve their candidacies or if some political action committees go beyond their intended prerogatives through the vehicle of 501(c)(3) entities.

My own view is that current law is already clear enough to distinguish even these situations as compliance matters rather than amendment ones, but if it is the wisdom of this body that sharper definitions are necessary, we would of course wish to cooperate.

My largest concern and plea is that whatever changes are considered to deal with inappropriate interference in partisan political activity, that there be no inadvertent amendment to the appropriate and necessary advocacy functions of nonprofit organizations. Any changes that are made should underscore that partisan political activity is illegal and therefore must be discouraged and that other advocacy and lobbying rights are legal and therefore should be encouraged.

Chairman **Pickle**. I thank you, that was a good statement, Mr. O'Connell, I appreciate it. We will comment on it in a minute.

Now Mr. Thomas Troyer. Are you also representing the Independent Sector?

Mr. **Troyer**. Yes, I am, Mr. Chairman.

Chairman **Pickle**. Are you in a different capacity than Mr. O'Connell?

Mr. **Troyer**. I am a member of the Washington law firm of Caplin & Drysdale. I represent a number of charitable organizations in my general practice, but I am appearing here today on behalf of Independent Sector.

Chairman **Pickle**. You are all together kind of two for one today, aren't you, or vice versa, however you look at it.

Anyway, Mr. Troyer, we are glad to hear from you.

STATEMENT OF THOMAS A. TROYER, CAPLIN & DRYSDALE, COUNSEL, INDEPENDENT SECTOR

Mr. **Troyer**. I would like to try to put a bit of this in perspective by summarizing very briefly for the subcommittee the experience that the full Ways and Means Committee and the Congress had the one time the committee and the Congress looked hard at a part of the subject of this hearing. That was in the period leading to the enactment of the 1976 legislation enabling public charities to choose more liberal rules governing their legislative activities.

Now it seems to me it is worth just a moment to refresh our memories of the objective that the committee and the Congress had back in the early 1970's when the subject came up, the process that the committee went through, in developing the law and then how the law has worked in actual practice over the last 10 years.

The objective was quite clear early on. The objective was to open the process to broader participation by public charities in the formation of public policy. The Ways and Means Committee had 3 full days of hearings on exactly this subject in 1972. Senator Nelson later stated the common theme: "The present law effectively inhibits a diverse, informed, and important segment of our society from presenting its views either to Congress or to State and local legislative bodies, and deprives legislators of the experience and knowledge of these charities." Again, he said, "These organizations represent the public in many important areas such as health, education, the environment. These groups have much information to contribute and a wide range of helpful experience that could greatly assist the consideration and the enactment of this country's laws."

Now, precisely those views were stated by a number of members of the Ways and Means Committee at that time, other Members of the House and by a number of Members on the other side of the Hill.

The full committee went through a very careful process of devising what became the 1976 lobbying liberalization law. It reviewed a number of evolutionary stages in the process toward that 1976 act. The final bill that was introduced in 1976 by Barber Conable was cosponsored by a number of members of this subcommittee, a number of other members of the Ways and Means Committee, and it was adopted on the Senate side without a single substantive word change in the bill, cosponsored by 43 Senators.

So the drafting of the 1976 law went through a deliberate, measured process, and it seems to me that our experience with the law since then shows that the Ways and Means Committee has every reason to be proud of what it did back in 1976. The law has been chosen—it is being used—by public charities that range from large national organizations like the ones that you will hear from on this panel, and others like the National Council on the Aging, and the American Lung Association to a host of State and local groups like the Minnesota Handicapped Federation, and the Alabama Girls Club, which has been very active with the Birmingham City Council and with the Alabama State Legislature on matters concerning community schools, the development of self-esteem, and the control of teenage pregnancy. The law has been used by a number of other organizations—a very great number of other organizations like that—at the State and local levels.

It seems to me that, in opening policy to these groups, the legislation has made a very helpful contribution to the process by which we make our laws. It permits national charitable organizations to talk to legislators. It permits State and local groups to talk to their local officials about pending legislation in their areas of concern. In each of those instances—day in and day out—it is very, very helpful. I hope that its use will be powerfully encouraged.

Thank you, Mr. Chairman.

[The prepared statement follows:]

Statement by

THOMAS A. TROYER
Caplin & Drysdale
Washington, DC

HEARINGS BEFORE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U. S. HOUSE OF REPRESENTATIVES

Room 1100, Longworth House Office Building
9:30 a.m., March 12, 1987

My name is Thomas Troyer. I am a member of the law firm of Caplin & Drysdale. I represent a broad range of charitable and educational organizations, and I am the former chairman of the Exempt Organizations Committee of the American Bar Association Tax Section. I appear today on behalf of Independent Sector. I appreciate very much the opportunity to participate in this hearing.

I would like to focus my comments on one part of the terrain which is the general subject of your hearing -- the highly important law that Congress adopted in 1976 to enable public charities to elect liberalized tax rules for their legislative activities. The Ways and Means Committee in particular spent a good deal of time and effort in developing that law. Nonetheless, memories fade; a multitude of important matters have consumed the Committee's attention over the intervening decade; and the membership of the Committee and the Congress have naturally changed over that time.

That said, it seems to me well to highlight three key aspects of the 1976 law: (1) the fundamental objective of the Committee and Congress in developing and enacting the statute; (2) the measured, deliberate process by which the law was formulated; and (3) the experience we have had with the statute since 1976.

Prefatorily, let me underscore two points about the tax laws governing charities that are left entirely unchanged by the 1976 law. First, since 1954 the tax provision for charities has squarely and absolutely ruled out any participation in political campaigns. From the beginning, that bar was absolute; Congress quite consciously left it intact as the 1976 law passed; and it remains so today. Second, the 1976 liberalizations were made available only to eligible public charities. Private foundations cannot make use of them. The very strict limitations that Congress specifically designed for the legislative activities of private foundations in 1969 were untouched by the 1976 law, and they, also, remain in effect today.

CONGRESSIONAL OBJECTIVE

For many years the Internal Revenue Code specified that, for a charity to be tax-exempt and eligible to receive deductible charitable contributions, "no substantial part" of its activities could consist of attempting to influence legislation. Over those years, neither the courts nor the Internal Revenue Service provided any real guidance about the meaning of the "substantial" test. The result was that the charitable community generally gave a very wide berth to any comment on any issue of public policy.

In the late 1960's, one charity departed from that precept -- and in a highly publicized case, lost its eligibility to receive charitable contributions by lobbying to prevent the flooding of the Grand Canyon. Several other charities were threatened with loss of their exemptions because of their legislative activities.

As those cases became known, they pointed up the fundamental irony of denying access to the public policy and legislative process to charities -- institutions by their nature formed for public purposes, rather than to advance the private financial interests of shareholders, employees, or others.

In 1971, Congress turned to the problem. In March of that year, Senator Muskie introduced the first of a series of bills designed to clarify and liberalize the tax law restriction on public charities -- and thereby to encourage them to participate more fully in the formulation of public policy at the local, state and national levels.

The legislative history is quite plain about the purpose of the Congressional effort.

Senator Nelson:

- "The present law governing legislative activities of public charities is unduly restrictive, difficult to administer, and undemocratic. The present law effectively inhibits a diverse, informed, and important segment of our society from presenting its views either to Congress or State and local legislative bodies, and deprives legislators of the experience and knowledge of these charities." 119 Cong. Rec. 5746 (daily ed. February 28, 1973)
- "These organizations represent the public in many important areas such as health, education, and the environment. These groups have much information to contribute and a wide range of helpful experience that could greatly assist the consideration and enactment of this country's laws." 119 Cong. Rec. 5749 (daily ed. February 28, 1973).

Rep. Conable:

- "The role of the charities in a pluralistic society -- something we are all dedicated to -- is constructive and the charities should not be muzzled." 119 Cong. Rec. 42632 (daily ed. December 19, 1973).

Sen. Muskie:

- "It makes no sense to decide that these organizations operate in the public interest and grant them tax-exempt status and then silence them when they attempt to speak to those who must decide public policy." 117 Cong. Rec. 8517 (daily ed. March 30, 1971).
- "These organizations can be a valuable source of information; they can broaden legislators' understanding of proposed legislation, and they can suggest valuable legislative alternatives." 121 Cong. Rec. 42028 (daily ed. December 19, 1975).

Sen. Dole:

- "Charities can be and should be important sources of information on legislative issues." 121 Cong. Rec. 42032 (daily ed. December 19, 1975).

THE EVOLUTION OF THE STATUTE

The 1976 statute was the product of a careful and deliberate process that took place over a period of five years. Broader efforts followed the 1971 beginnings. In 1972, bills were introduced in both the House and the Senate. The Ways and Means Committee held three full days of hearings on the subject in 1972. More than 100 witnesses submitted testimony at those hearings. Russell Train, the Chairman of the Council on Environmental Quality, testified strongly about the capacity of charities to make important contributions to the consideration of public policy -- and, specifically, legislative policy -- and urged the Committee to allow charities sufficient freedom to make those contributions. Members of Congress, the Chairman of the Tax Section of the American Bar Association, and a wide range of other organizational representatives and individuals testified in favor of liberalization of the existing tax restraint on charities' legislative activities.

At least eleven bills with that essential objective were introduced from 1971 to 1976. During this period, there were a great many meetings among Ways and Means Committee members, other interested members of Congress, the staff of the Joint Committee on Internal Revenue Taxation, Treasury, and representatives of the charitable community. These discussions produced repeated revisions of the draft legislation. The Joint Committee draftsmen devoted many days and much hard thought to devising and refining legislation that would meet the objectives of Congressional proponents and, at the same time, resolve concerns expressed by Treasury or by one or another member of Congress.

Additional hearings were held by the full Ways and Means Committee in 1976. The Coalition of Concerned Charities, consisting of some 80 public charities, expressed its support for the final bill. The Treasury representative supported the bill without reservation, stating Treasury's belief in its worth for the legislative process and the Department's understanding that it comprised both a clarification and a liberalization of existing law.

The statute that emerged from this painstaking process drew very broad bipartisan support. Chairman Ullman had long been a vigorous proponent. The Committee's senior Republican, Congressman Barber Conable, had for some time led the effort to press the legislation to enactment, and he introduced the final bill. Among the members of the Ways and Means Committee who sponsored that bill were Congressmen Gibbons, Rangel, Vanderjagt and Frenzel. The forty-three Senators who joined in sponsoring the Senate counterpart of the Ways and Means Committee bill included Senators Muskie, Dole, Baker, Cranston, Stevens, and Leahy.

The statute that resulted is a detailed addition to the Internal Revenue Code, reflecting the care employed in its development. In essence, it enables eligible public charities to elect to spend, for their legislative activities, fixed percentages of their total annual expenditures for charitable purposes. Electing charities can spend no more than one-fourth of those fixed ceilings for grassroots legislative activity. Very helpfully, the statute defines with some precision classes of activities that are not to be considered attempts to influence legislation.

RESULTS SINCE 1976

The 1976 statute has been in effect for a decade now. About 3,300 public charities have elected to be covered by it. Although they are so far a small part of the universe of theoretically eligible organizations, they represent an important and diverse part of the charitable community. They include, for example, such well-known national charities as the National Council on the Aging, the American Lung Association, the National Audubon Society, Reading is Fundamental, and the several national charities about which other members of this panel will testify in detail. The list also includes a host of less prominent names. Local charities bulk large in it. A sample gives a sense of the group:

Citizens for Safe Drivers
Able Disabled of Beaver County [Pa.]
Dallas Zoological Society
Travelers Aid Society
Connecticut Library Association
Keep Austin Beautiful, Inc.
Suicide Prevention of Florida, Inc.
Alaska Foster Parents Association
Brandon [Oregon] Historical Society
Buckley [Washington] Beautification Club
Ketchikan [Alaska] Youth Football League
San Carlos Volunteer Firemen, Inc.
Society for Pediatric Research
Birmingham Music Club, Inc.
Elizabeth City [N.C.] Girls Club
Friends of the Zoo [New Orleans]
Morgan County [Alabama] Association for Retarded Citizens
Committee to Preserve Assateaque Island
Tennessee Conservation League
American College of Allergists, Inc.
Arizona Opera Company
Big Horn Education Fund, Inc.
Coalition for Persons With Disabilities
Society's League Against Molesters
Prince William League for the Protection of Natural Resour. [Va]
Brothers Keeper Mission, Inc.
Salt Lake Acting Company
Colorado Association of Soil Conservation Districts
County Sheriffs of Colorado, Inc.
Society for Traditional Music
Junction City Arts Council [Kan]
House of Neighborly Service
Junior League of Topeka, Inc.
Old Fort Historic Sites, Inc. [N.C.]

I know from my own experience as counsel to a variety of charitable organizations that the 1976 law has had its intended effect of clarifying the standards and enabling public charities to communicate their information and views, within the statute's specifically stated limits, on legislative matters. Groups like those I have listed have made a great many useful contributions to public policy debates on a variety of issues at all levels of government. For example:

- The American Council of the Blind provides information to lawmakers on the impact of policy decisions on those whose vision has been impaired. When Congress considered reduction of the postal subsidy supporting, among other things, the Blind and Visually Handicapped Mailing Privilege, the Council demonstrated the effect of the proposed reduction for those who would, under it, be unable to afford postage for braille and recorded materials.

- The New York chapter of the National Parks and Conservation Association urged the State legislature to put the Environmental Quality Bond Act to a referendum. Approved by the voters, the Act, among other things, provides for State purchase of land for permanent preservation.

- The Girls Club of Alabama (Birmingham) addresses itself to such concerns as teenage pregnancy, the development of self-esteem in the community school system, and the prevention of sexual abuse. Concentrating particularly on modes of preventing teenage pregnancy, it has worked with the Mayor's Commission of Women, the State legislature and members of Congress.

- The United Handicapped Federation of Minnesota succeeded in its work to save the planned expansion of the Metro Mobility Para-Transit Program from state budget cuts. The program's expansion entails service to and from the metropolitan area surrounding St. Paul and Minneapolis. About 10,000 disabled riders benefit.

- The National Council on the Aging, in its work with the Senate Committee on Aging, provided important assistance in creating Title V of the Older Americans Act, the Senior Services Employment provision. The Act adds a new component to federal support of services to senior citizens that contrasts with previous emphasis on services to dependent persons. By offering increased employment opportunities, the Act is intended, over time, to reduce dependence upon government services.

- Former Florida Governor Graham organized the Everglades Coalition -- composed of groups such as the Florida Audubon Society and the Wilderness Society -- to examine the problems of the water system in South Florida. The Coalition's work involved both state and federal laws concerning budgets, water restoration, and other issues affecting the water supply.

Charities like these -- and activities like these -- do not appear on the front page of the New York Times. Most of them do not appear on any page of any paper anywhere. Dan Rather does not tell us about them on the evening news.

For a Subcommittee assessing the legislative activities of charities, nonetheless, they are the real world. Day in and day out, groups like these work with city councils, county councils, members and committees of state legislatures and, from time to time, Congress. To the extent that the tax law permits them to do so, some of these charities encourage other citizens to express their views to those governmental bodies. Undramatic though most of it is, that citizen activity on public issues is just what the 1976 tax law was intended to encourage -- and just what it has produced for the charities electing it.

I hope that it will soon be clear that its beneficial effect continues -- and that more charities will be encouraged to elect it. Most made preliminary judgments about the 1976 law soon after its enactment, and a good many decided to postpone final choice until regulations appeared. One can readily understand their hesitation: the law represented a sharp departure from the exceedingly negative tax rule by which both public charities and their lawyers had been conditioned for more than forty years. Supportive exposition, in the strongly positive spirit of the new law, was much in order.

Regulations did not appear, though, until the proposal of last November. I know that Subcommittee does not want this hearing to include discussion of the proposed regulations and the considerable controversy which has attended them. I very much hope, however, that the controversy will conclude with regulations which carry out the fundamental, compelling objective of the 1976 law.

The law achieves that objective when it frees a large national charity to participate in a significant national issue. Much more commonly, it achieves that end when it frees a local charity to talk to its local officials. The public policy work of the United Way of America is highly important. The work of the Birmingham Girls Club is also important. So, too, is that of the Minnesota Handicapped Federation, the Morgan County Association for Retarded Citizens and the Tennessee Conservation League.

Indeed, these groups and their work are more than important. They are an essential part of the functioning of our democracy. In permitting such charities broader access to their representatives in city, county, state, and national legislative bodies, the 1976 law performs a function of vital significance to the workings of our democratic processes. Public charities should receive powerful encouragement to use it.

Chairman **Pickle**. Next we will hear from Dr. Harold Freeman, director of surgery, Harlem Hospital Center, New York, testifying on behalf of the American Cancer Society.

STATEMENT OF HAROLD P. FREEMAN, M.D., DIRECTOR OF SURGERY, HARLEM HOSPITAL CENTER, NEW YORK, CHAIRMAN, NATIONAL ADVISORY COMMISSION ON CANCER IN THE SOCIO-ECONOMICALLY DISADVANTAGED, AMERICAN CANCER SOCIETY

Dr. **Freeman**. Thank you, Mr. Chairman. I appreciate the privilege of coming before this committee today.

I am Dr. Harold Freeman, director of surgery at Harlem Hospital Center in New York City, associate professor of clinical surgery at Columbia University. I am also the chairman of the American Cancer Society's National Advisory Committee on Cancer in the Socioeconomically Disadvantaged.

I would like to underscore the meaning of that. The Cancer Society has a committee to look at the disparate and negative results in the poor population in relation to cancer.

I would like to tell you about the American Cancer Society and lobbying. As you know, we are a 501(c)(3) organization, so that by definition, lobbying is not a major activity for the ACS. Although the society did not elect to come under the 1976 law, we were active in working for its passage because we felt that the term "substantial" in section 501(c)(3) required clarification and that it was necessary to provide guidelines and definitions of what constituted lobbying by such organizations as ours.

The 1976 law, we feel, is a good law. It did clarify the issue. It provided definitions and explanations both for those organizations which elected to abide by the new law as well as those that chose to stay under the "substantial" provision.

It enabled organizations like the ACS to lobby without fear of having their tax exempt status removed.

Why would an organization like the ACS lobby? It is not a trade association charged with protecting the economic or professional interests of its membership. It is not a political activist group. In fact, we are prohibited by law from raising or donating funds to candidates or political action groups. We must stay clear of involvement or any perception of involvement in political campaigns at any level.

The ACS does not accept any Government money, so our annual call for a higher appropriation for the National Cancer Institute doesn't benefit our organization by one penny. We don't represent any special interests such as business, industry or a commodity.

The purpose of the American Cancer Society is, put very simply, to do everything possible to work towards the elimination of cancer as a threat to human health, happiness, success and well-being. We do this through the active involvement of 2.5 million volunteers backed by a cadre of professional staff. These people are organized in every county, every State, the District of Columbia, and Puerto Rico.

The society serves the public at the community level at no cost to the Government through service education and research programs.

In 1986 the American public expressed its support of the American Cancer Society's programs by contributing more than $270 million.

This year our private sector program of cancer research will support a $90 million research budget second only to the Government, through the NCI. In addition, we will spend over $89 million in our public and professional education efforts, and direct service to cancer patients will total nearly $42 million.

Who do we work for? We work for the cancer patient, the potential cancer patient. Mr. Chairman, our constituency, so to speak, may very well be represented among the people in this room. I suspect that it is. Cancer is indiscriminate, relentless and ruthless. It knows no political affiliation, preference or boundary lines. It does not recognize social, economic, cultural or ethnic distinction. It does not seem to care whether you are black or white, whether you are rich or poor, whether you are a genius or a fool; it will strike anybody.

Statistics show, in fact, that 30 percent of all Americans will develop cancer within their lifetimes. This enemy comes in more than 100 different forms, and the Cancer Society estimates that 483,000 Americans will die of cancer this year. Most of these deaths are preventable, and we function to prevent as many of these deaths as possible in the light of current knowledge and resources.

I will point out, too, that more years of life expectancy are lost due to cancer than are lost due to any other disease, including heart disease, which strikes, usually, at a later stage of life.

We are making significant progress against cancer. More progress has been made in the last 25 years than in all previous recorded history. I would like to point out that much of this progress against cancer has come about as a result of the wisdom that you and your colleagues in the Congress have exercised in providing support for the National Cancer Institute.

You passed the National Cancer Act in 1971. Much of the progress against cancer through research in recent years has been derived from the passage of that law. We, the ACS, lobbied for that law, and each year since we have lobbied for increased funding levels for the National Cancer Institute.

The ACS wants to keep the battle against cancer as the top sustaining health priority in the Nation, and we believe that the American public agrees with this. Every year Americans vote for this priority with their wallets and their pocketbooks when they contribute to the cancer crusade, and every year they contribute approximately 10 to 12 percent more than the previous year.

We believe that by doing this, they are not only indicating their own priorities but they are also sending a message to the Congress about where they would like to see Government funds for health spent.

The American Cancer Society contributes in a substantial way to the information and knowledge that you draw upon in making important legislative decisions regarding cancer. The society's two cancer prevention studies have been a main source of expertise for epidemiological data on cancer, carcinogens and the effect of lifestyle and other pertinent information.

Cancer is more than a health and a medical issue. It has become a social, economic, cultural, ethnic and psychological issue, and as a result, it is becoming more and more affected by Government action at the legislative and regulatory levels.

Chairman **Pickle**. Dr. Freeman, the Chair would like to ask you to summarize your further statement if you can, particularly as to the lobbying and the political activities. I notice you are not much more than halfway through your statement, and if you could summarize, it would be of assistance to the committee and, I think, to the people who are waiting to testify also. Could you do that?

Dr. **Freeman**. All right.

In overview, Mr. Chairman, we are an organization that has tax exemption. We get our money from the public. We are a very legitimate organization. We are not political. We support no candidates. We are only interested in one point, and that is the reduction and elimination of cancer in the American society.

Our fear is that strict changes in regulations, while developed with the best of intentions, could on the other hand have a negative effect on organizations in which the public has great confidence; which provide bona fide service to the American public.

We ask that you not throw out the baby with the bath water. We ask that you not burn down the house to roast the pig. What we fear is that this may be done if there is not great sensitivity, consideration, and developing the regulations, as well as any legislation that may be considered.

The rest of my statement you can read. Our general concern is that a society, and an organization such as ours and other similar ones that have proven records for aiding the American public with no hidden agendas, not be harmed as the result of your efforts to correct the problems created by other organizations that have been mentioned here this morning.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF HAROLD P. FREEMAN, M.D., ON BEHALF OF THE AMERICAN CANCER SOCIETY

I am Dr. Harold Freeman, Director of Surgery, Harlem Hospital Center, and Associate Professor of Clinical Surgery, Columbia University. I am also the Chairman of the American Cancer Society's National Advisory Commission on Cancer in the Socio-Economically Disadvantaged.

I'd like to tell you about the American Cancer Society (ACS) and lobbying. As you know, we are a 501(c)(3) organization, so by definition, lobbying is not a major activity for the ACS. Although the Society did not elect to come under the 1976 law, we were active in working for its passage because we felt that the term "substantial," in section 501(c)(3) required clarification, and it was necessary to provide guidelines and definitions of what constituted lobbying by organizations such as ours.

The 1976 law is a good law. It clarified the issue. It provided definitions and explanations, both for those organizations which elected to abide by the new law, as well as those that chose to stay under the "substantial" provision. It enabled organizations like the ACS to lobby without fear of having their tax exempt status removed.

Why would an organization like the ACS lobby? It is not a trade association, charged with protecting the economic or professional interests of its membership. It is not a political activist group -- we are prohibited by law from raising or donating funds to candidates, or political action groups. We must stay clear of involvement, or any perception of involvement in political campaigns at any level. The ACS does not accept any government money, so our annual call for a higher appropriation for the National Cancer Institute doesn't benefit our organization one penny. We don't represent any special interest, such as a business, industry, or commodity.

The purpose of the American Cancer Society is to do everything possible to work towards the elimination of cancer as a threat to human health, happiness, success, and well-being. We do this through the active involvement of two and one-half million volunteers, backed by a cadre of professional staff; organized in every county and every state, the District of Columbia, and Puerto Rico. The Society serves the public at the community level, at no cost to the government, through service, education and research programs. In 1986, the American public expressed its support of the American Cancer Society's programs by contributing more than $270 million to the ACS.

This year our private sector program of cancer research support will approach $90 million -- second only to the government's National Cancer Institute. We will spend over $89 million on our public and professional education efforts. Direct service to cancer patients will total nearly $42 million.

Who do we work for? -- the cancer patient, and the potential cancer patient. Mr. Chairman, our constituency -- so to speak -- may be represented among the people in this room. Cancer is indiscriminate, relentless, and ruthless. It knows no political affiliation, preference, or boundary lines. It does not recognize social, economic, cultural, or ethnic distinction. Statistics show that 30% of all Americans living today will develop cancer in their lifetime. This enemy comes in more than 100 different forms, and the Society estimates that 483,000 Americans will die of the disease this year. This may sound gloomy. The fact is that this natural enemy of living things -- cancer -- which is, after all, best characterized and understood as a defect in the growth control mechanism of cells in the living organism, is yielding to man's attempts to control it.

We are making significant progress against cancer. More progress has been made in the past 25 years than in all previously recorded history. But the problems won't go away. Cancer is a basic biological phenomenon. Our growing understanding of its nature and its causes, coupled with our gains in treating and preventing it, represent one of man's greatest achievements. Scientific advances have brought about an explosion of knowledge about cancer and its process, about hereditary factors, the immune system, development of chemical intervention, better surgical and radiologic techniques, and improved understanding of the effect on life styles with cancer control. The biggest frustration in the battle against cancer is the continuing addiction of so many people to smoking. Not smoking, or stopping smoking, is a known way to prevent cancer. Our record against this disease would be far better if people would not smoke.

Many of these recent gains against cancer have come about as a result of the wisdom you and your colleagues in the Congress have exercised in providing support to the National Cancer Institute. You passed the National Cancer Act in 1971. Much of the progress against cancer through research in recent years is derived from that law. We lobbied for that law and we lobby every year for increased funding levels for the National Cancer Institute. The ACS wants to keep the battle against cancer as the top sustaining health priority of the nation. And we believe the American public agrees. Every year, Americans "Vote" for this priority with their wallets and pocketbooks -- when they contribute to the cancer crusade. And every year they contribute approximately 10 to 12 percent more than the previous year. We believe that by doing this, they are not only indicating their own priorities, but they are also sending a message to the Congress about where they would like to see government funds for health research spent.

The American Cancer Society contributes, in a substantial way, to the information and knowledge you draw upon to make important health decisions regarding cancer. The Society's two Cancer Prevention studies have been the main source of expertise and epidemiologic data on cancer, carcinogens, the effects of lifestyle, and other pertinent information.

Cancer is becoming more than a health and medical issue. It has become a social, economic, cultural, ethnic, and psychological issue, and as a result, it is becoming more and more effected by government action at the legislative and regulatory levels. Two major areas where these effects are felt are third-party reimbursement and cost containment programs.

Our lobbying activities have only one purpose -- to assist government in taking sensible action to help the person with cancer, the person who has survived cancer, and the person who may develop cancer.

In addition to supporting the NCI appropriation and authorization, we work for legislation which will help more Americans have greater access to early detection and prevention procedures.

For example, we support legislation to provide Medicare coverage of cancer screening techniques such as mammography, which are currently only covered if done as part of a diagnostic procedure. The Society believes that mammography is the state-of-the-art procedure for detecting breast cancer at the earliest possible stage. Right now mammography is a relatively expensive procedure. Legislation before the U.S. Congress would result in lowering the cost, and would ensure its availability to more women, thus having a life-saving effect.

I doubt that the relationship between tobacco and cancer, is a new subject to the Members of this committee. We lobby for legislation to restrict the use of tobacco products because we firmly believe that it will save many lives and cut down on the millions of dollars of health care costs attributed annually to smoking-related disease and death. Our anti-smoking agenda is limited. For example, the American Cancer Society claims no expertise in revenue legislation, and for years, we avoided involvement in cigarette excise tax legislation because we could not defend it on the basis of saving lives from cancer. Cancer is our only area of expertise, and we adhere strictly to that as the determinant of our involvement in lobbying. Then, Dr. Kenneth Warner of the University of Michigan demonstrated in convincing research the direct correlation between the cost of cigarettes on cigarette consumption, and the corresponding decline in the number of young people who start to smoke. He predicted that doubling of the federal excise tax would result in a 4% reduction in consumption among adults, and a 14% decline in consumption among teenagers. This would significantly reduce the number of new smokers that the tobacco companies "recruit" every year to replace smokers who die, or quit. To the American Cancer Society, this reduction in smokers, translates directly into lives saved from cancer -- twenty, thirty and forty years from now. Warner's prediction was right on target. The tobacco industry reported, two years after the doubling of the tax, that consumption had dropped 4.5%. The report did not give any figures on reduction in numbers of teenagers beginning to smoke, but we believe in the accuracy of Dr. Warner's prediction.

Another issue of concern to us is the number of persons who experience employment-based discrimination based on their cancer histories. Mr. Chairman, we have a population of more than 5 million Americans who are living normal lives -- who have beaten cancer and want to return to their "normal" lives as working, contributing members of society. Many of these cancer survivors, however, return to work only to find themselves demoted, transferred, fired, or without needed insurance benefits for themselves and their families. While this discrimination is often subtle, many employers still believe in the myth that cancer is contagious. By working with Members of Congress, the American Cancer Society hopes to pass legislation to better protect cancer patients from such discrimination, and to educate the public that cancer is not always a deathly disease and they must do everything possible to assist the survivors in this important step to full recovery.

Other issues for which we lobby include the extension of the charitable contributions deduction for nonitemizers, and maintaining the third-class nonprofit postal rates. These issues might be called "self-interest" issues, but they are excluded from the total amount of expenditures attributable to lobbying because they are considered by Congress as an incentive for private sector service to the public. But these are also areas in which there has been abuse. We would welcome the opportunity to work with Congress to help check such abuses by organizations who do not meet all the qualifications of a 501(c)(3) group.

I have a special interest in helping retain the right of organizations like ACS to lobby, Mr. Chairman. My interest is related to the problem of inaccessibility of millions of socio-economically disadvantaged Americans to adequate health care. By working with you on legislative initiatives to address some of these problems -- the costs of catastrophic illnesses such as cancer, unavailability of insurance for those persons with histories of high risk diseases, providing coverage for preventive measures and screening techniques -- I believe the ACS will fulfill its sworn service to the cancer patient and potential cancer patient.

Mr. Chairman, we do all this because the ACS is an active, responsible, member of the community -- at the local, state and national levels. The American public looks to the Society for information about cancer, what can be done to lessen the impact, how it can be prevented, what the advantages of early detection are, and how that can be accomplished.

Even though we don't know who all of our constituents are, we feel the responsibility to represent them as a group, when important issues come before, and are addressed by the government.

We could stop tomorrow, close our Washington Public Affairs office, and move back to New York. We don't have to be here serving as a resource to government and the Congress. But, as a volunteer for the American Cancer Society, I am giving up a day in the operating room, seeing patients, teaching students, and training interns and residents, to come and tell you one simple fact. It is a vital part of our American system for organizations like the ACS to be able to, without fear of penalites, or of compromising our tax-exempt status, to make its knowledge and expertise directly available to you -- the elected official -- so that for a complex subject like cancer, you will have ready access to the kind of information you need to make informed, intelligent decisions in the public interest.

Chairman PICKLE. I thank you, and I appreciate your cooperation. I thank you for your statement.

Now we've got Mike Hudson. You will be the next gentleman, Mike.

STATEMENT OF MICHAEL HUDSON, ATTORNEY-AT-LAW, AUSTIN, TX

Mr. HUDSON. Mr. Chairman, thank you very much for the opportunity to be here in Washington and to appear before your subcommittee.

I suppose that perhaps my primary qualifications for appearing on this topic today are that I probably represent more nonprofit charitable entities in the 10th Congressional District of Texas than anybody else in the Austin area. So perhaps I can shed a little light on the question that I've heard expressed several times today, that——

Chairman PICKLE. Well, Mike, you represent more organizations than anybody else on this panel right now, so you're entitled to say something.

Mr. HUDSON. As is mentioned in my statement, since graduating from the University of Texas Law School in 1973, my history of employment has been exclusively in the nonprofit organization field.

Currently, as I mentioned before, I am the Texas director of the Children's Defense Fund. I am the Texas director and general counsel of People for the American Way. I am the president of the Texas Public Interest Center and the cochair, along with the March of Dimes, of the Texas Maternal and Child Health Coalition, which is a network of more than 50 statewide Texas organizations that have tax-exempt status and are engaged in public education and public advocacy activities.

Based on my 15 years of experience, primarily in Texas and in Washington as well, I am absolutely convinced that the robust and frequent participation of nonprofit charities in the public advocacy process has made us a better country and has demonstrated the types of activities that the American public would want to promote and support through the tax laws.

Likewise, I am convinced through these activities that the vast majority, the overwhelming majority, of these public charities know full well the difference between public advocacy or lobbying activities and electioneering or partisan political activities. Further, I am convinced that the overwhelming majority do not participate in this latter proscribed activity.

The first reason that I believe that public charities are so important in this area is that this type of advocacy before governmental bodies, fills what otherwise would be a large vacuum. I think the basic question is: Who, if not the public charities, would speak out for those who are otherwise not represented, who are not members of unions, have no trade organizations, who don't make political contributions?

Who otherwise would speak out for the homeless, the medically indigent, or even the average taxpayer who is not a joiner of an organization?

Second, it seems to me, even if the public charities are not seeking redress for some group who has been harmed or needs services, that generally they seek to promote the interest of the general public and the general welfare.

I could cite a number of stories throughout my 15 years experience that I think would document and justify these conclusions. I will briefly summarize only two recent ones.

As I mentioned, I serve as the codirector of the Maternal and Child Health Coalition.

Mr. Chairman, I know that you are very familiar with the monumental efforts we launched in the 1985 Texas Legislature to address the problem of indigent health care.

During that session the Texas Legislature was facing a $1 billion revenue shortfall in January of 1985. Primarily through the work of the Maternal and Child Health Coalition, the public charity sector, we were able to convince county judges, county commissioners, local health providers, and members of the Texas Legislature that something had to be done about the growing serious problem of medical indigency. And through those public education and public advocacy campaigns, we were able to convince the Texas Legislature at this time of budget shortfall to appropriate $200 million new dollars in Federal, State, and local spending to address the problem of medical indigency.

With due respect, I would suggest that that monumental effort, worked on by so many organizations, would have been impossible were it not for the efforts of the public charity and the tax-exempt community.

I ask again rhetorically, in a situation like this, who would have been there to speak out and represent the interest of the 70,000 pregnant women and young children living below poverty in the State of Texas who were the ultimate beneficiaries of these programs?

My second brief example concerns the Texas Public Interest Center, which I serve as president. This organization had become concerned that the debate over tort reform, which has occurred in many other States and is now occupying——

Chairman PICKLE. Debate over what?

Mr. HUDSON. Tort reform, liability insurance and tort reform. That is now occupying daily the interest of the Texas Legislature. We were concerned that perhaps a perspective, the public policy perspective, would be missing from this debate.

So we took our concerns to the University of Texas Law School and professors there and developed several studies on issues of tort reform, on issues of how public charities in the nonprofit sector could be served.

Again, as late as this week, I am convinced that this public policy research and advocacy will lead to progressive and good laws adopted by the Texas Legislature to address this very difficult issue.

My final point concerns the issue of privatization. For 6 years, we've heard a lot about the private sector and what it ought to do, and that we can't rely on government for everything. It seems to me that the issue of public charities and the tax-exempt sector engaging in advocacy, public policy advocacy, is a perfect example of privatization that our taxpayers and American voters would surely support.

Thank you, and I'd be happy to answer any questions, Mr. Chairman.

[The prepared statement follows:]

STATEMENT BY

MICHAEL HUDSON, Attorney-at-Law
316 West 12th Street
Austin, TX 78701
(512) 472-2223

HEARINGS BEFORE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U. S. HOUSE OF REPRESENTATIVES

March 13, 1987

Mr. Chairman and Members of the Subcommittee, I am Michael Hudson, an attorney from Austin, Texas. Today, I appear on this panel speaking for myself. In my testimony, however, I will describe the activities of a number of public charities that I represent in Texas.

Since completing the University of Texas School of Law in 1973, I have represented and worked exclusively for nonprofit and charitable organizations. In 1973, I was the first executive director of the Texas Public Interest Research Group (TxPIRG), which was active in a number of consumer public policy issues. Thereafter, from 1974-78 I was the Director of Public Affairs of the University of Texas System, an institution with charitable status and wide-ranging interest in and influence over public policy issues.

During 1979-81, I was a staff employee for the U.S. House of Representatives, an institution that I suppose qualifies as a nonprofit entity as well. And, from 1982 through the present, I have represented a large number of national and Texas public charities. In my representation of nonprofit organizations, I am deeply involved in their public education activities and their public policy advocacy, including appearances before the Texas Legislature and occasionally before Congress.

In an effort to respond to the charge from the Subcommittee, I will describe two specific public policy campaigns in Texas, which I have directed in recent years. These efforts by the charitable, nonprofit community, in my view, are exemplary of the public policy advocacy programs among most public charities and demonstrate why these activities are so critical.

Initially, however, I want to underscore my long-held, and frequently verified belief that the Congress has acted wisely in encouraging, through the tax laws, the participation of tax-exempt organizations in public policy debate. Based on my 15-plus years of experience I am convinced that the robust participation in research, public education and advocacy by charitable groups has greatly benefited this nation. Moreover, it is my view that the laws, including the 1976 effort to clarify how much lobbying was permissible, generally are working well and are effective in promoting the desired public policy. Likewise, I believe that the vast majority of the public charities understand well the difference between public policy advocacy or lobbying on issues and political activities or electioneering. I am convinced that most are not engaged in this latter proscribed conduct.

The first reason that public charities ought to be involved in advocacy before governmental bodies is that their input fills a large vacuum. My years of experience before Congress -- and especially before the Texas Legislature -- teach me that were it not for the charitable community our public policy would be in much worse shape. The basic question is, who if not the public charities is going to represent those who have no unions, who have no trade organizations, who don't make political contributions? Who is going to speak out for the homeless, the medically indigent, or even the average taxpayer who is not a joiner?

Secondly, it occurs to me that our nonprofit community -- even if it is not seeking redress for some unrepresented group -- generally seeks to promote the interests of the general public. Many, if not most, of the truly unbiased studies and recommendations for sound government policy have come from the public charitable community.

I could cite many stories to substantiate these conclusions, but let me relate only two. These are two public policy efforts with which I have been associated in Texas over the past two years. In my view both have lead to a better Texas, improved policy making by the Texas Legislature and were fostered by the current federal tax policy regarding tax-exempt charities.

The first involves my work since 1985 with the Texas Maternal & Child Health Coalition. The Coalition is a network of over 50 statewide organizations -- most of whom enjoy some tax-exempt status. The groups range from the March of Dimes, to the Texas Hospital and Medical Associations, to the American Red Cross to the Texas Perinatal Association. The Coalition was formed to promote improved health care for medically indigent pregnant women and young children in Texas.

Our first order of business, in 1985, was to educate Texans about the desperate need for health care for the indigent and to promote the recommendations made by a Task Force on Indigent Health Care. The Coalition went on the road, meeting with local health providers, local government officials, community organizations and media across the state. We prepared fact sheets on the recommendations and did cost analyses of how much money county hospitals in Dallas, Houston and Austin were losing each year on uncompensated care. And, we took our message to state legislators, both in their home districts and in Austin.

The result was the most historic step Texas has ever taken in addressing the issue of health care for the indigent. Two hundred million new dollars in federal, state and county funding was approved -- in a year when the Legislature faced a one billion dollar revenue shortfall. This monumental public policy success, I suggest, could not have been accomplished without the work, resources and involvement of tax-exempt, public charities in Texas.

I ask again, in this situation who would have spoken for and represented the interests of the 70,000 pregnant women living below poverty who are the ultimate beneficiaries of these programs? I am convinced that the State of Texas in 1987 is a better place because of the public policy advocacy efforts by these tax-exempt organizations. Moreover, I am equally convinced that the citizens of Texas would agree that this private sector effort is precisely what should be encouraged and supported in our tax laws.

My second example involves the Texas Public Interest Center (TxPIC), of which I serve as president. This research and education organization was formed because of the need for more input with Texas public policy makers from groups representing consumers. TxPIC's two major projects over the past year include the publication of the Texas Maternal & Child Health Alert, a forum on state public policy related to health care for pregnant women and children and a study of so-called tort reform proposals, now occupying the Texas Legislature.

TxPIC took its concern to the University of Texas School of Law, were we were able to enlist a dozen law professors to review the various proposals -- strictly from a public policy perspective. From that review TxPIC has published a major study, endorsed by six of the professors, on the issue of Joint & Several Liability. TxPIC has also been involved in developing proposals to address the particular needs of nonprofit entities themselves and the needs of public servants who provide services for the state and cannot find adequate insurance.

These studies and recommendations have not been advanced by any of the other "major players" in the debate. Our recommendations have been shared with interest groups, the media, the tort study committee, and with the legislative committees. As of this week, I am convinced that several of the TxPIC proposals -- proposals developed by a tax-exempt charity -- will form the basis for compromise and for some of the ultimate laws adopted by the Texas Legislature.

Again, my real life experience causes me to ask, who would have attempted to represent the public policy interest or the interest of the average victim in liability cases if not the public charity sector?

Mr. Chairman, I could go on about similar experiences in creating the first Texas Public Utility Commission, in winning approval of a generic drug substitution law, or about changing a 20-year textbook adoption law that had negatively impacted the entire nation. But, my message to you is exemplified in these two examples. If it weren't for the work, and yes the advocacy, of the tax-exempt sector -- at least in Texas -- the general welfare would be the loser.

I would like to address one final issue and that is the desirability of encouraging private foundations to support and fund the public policy activities of public charities. It seems to me beyond question that the public does and will support charitable status for foundations that promote the type of public policy improvements I have outlined above. Further, it seems to me that federal law and regulations should encourage this type of giving.

For the past six years, the administration has been encouraging privatization and telling us that the government can't do it all. Well, nowhere is that more true, it seems to me, than in the area of charitable giving to public charities. I shutter to think how many more legislative staff it would take in Texas to compile, analyze and publish the information and research now undertaken by the public charity and tax-exempt sector. In the spirit of privatization, it seems that we should be encouraging this type of private philanthropy.

Chairman Pickle. Thank you, Mr. Hudson.

Now, Mr. Moskowitz, we would ask you to present your statement.

STATEMENT OF JACK MOSKOWITZ, SENIOR VICE PRESIDENT, GOVERNMENT RELATIONS, UNITED WAY OF AMERICA

Mr. Moskowitz. Thank you, Mr. Chairman.

First, I'd like to say that the statement I'm giving is endorsed and subscribed to by 17 national voluntary agencies associated with the United Way. I'll submit their names later for the record. They include the Red Cross, Catholic Charities, the Council of Jewish Federations, YMCA and YWCA.

It was very encouraging to me to hear the committee and most of the witnesses voice support for existing law and suggest moving cautiously and not tampering with it. I was especially encouraged to hear these view's expressed by Secretary Mentz. I'm here to speak in support of the 1976——

Chairman Pickle. Well, I don't believe he said, "Don't tamper with it." He didn't want a wholesale change in it. He didn't say you couldn't make some modifications.

I didn't take that as an indication from Mr. Mentz that he didn't think we could make any corrections. I didn't understand it that way at all.

Mr. Moskowitz. I'll agree with that, Mr. Chairman. It is the position to move cautiously that I'm supporting.

As a matter of fact, United Way and the agencies they support would have no problems accepting the Secretary's recommendations.

That leads to my second statement. I know of no United Way that has an affiliated 501(c)(4) organization. I might say also, and I think I can speak for a great number of health and human care providers in Austin or, for that matter, in Arkansas, that the last thing in their minds, in the minds of the volunteer boards that run them, would be to form an affiliated organization.

United Ways, this year, are going to be 100 years old. As part of our centennial program, the 2,200 United Ways which raised $2.44 billion in 1986 are being urged to double their community resources by 1991. That really can't be accomplished without some involvement with governmental units. And that is why we are in strong support of the 1976 changes.

One of the examples in my testimony is in the city of Austin, where the county and the city get together with the United Way to provide for the planning of human care services. And that's true of almost every major community in the United States.

I think any major change in the 1976 act would have a deterrent or chilling effect on that kind of activity, and that is why I'm here to support the major thrust of the 1976 act—especially those sections that gave charities who elected, under 501(h), the unlimited ability to do certain things.

One is responding to written requests for testimony from a legislative committee or other governmental body. At the local level—in every State, in every community—United Ways are repeatedly called on during the planning of the provision of services, both in the human care and the welfare services areas, by county boards, city councils, and State welfare commissioners. Therefore, I think such activity, unfettered, is very important.

The second exception that the 1976 act allowed public charities to do without limitation was presenting the results of nonpartisan analysis, study, and research. For example in Illinois, the Chicago agencies for the aging and the United Charities of Chicago were asked to provide information on health care to older family members in the home that was used to develop a low-cost program that would provide care in the homes rather than institutions.

The third exception in the 1976 law that we think is extremely important is communication with members. Now as far as my work and my job, I would say that probably 60 or 70 percent of my activity is communicating with my members. Our members want to know what's happening here. They need to know what the Federal budget is going to look like. We're very interested in the social services block grant that's in the jurisdiction of this committee. The block grant goes out to the States and is then funneled into local communities. The ability to plan for the human care services that are funded by the block grant is essential. So I think the unfettered ability to communicate with our members is also essential.

Mr. Chairman, the point I was trying to make in the beginning, and the reason I really was heartened by the Secretary's support of is the 1976 law is that the problem is not an excess of legislative activity by United Ways and their agencies. The problem is that they're probably not doing enough in providing input in public policy. What we need to do is encourage that public policy activity, not discourage it.

So our concern, also expressed by the other witnesses here, is that widespread tampering with the 1976 law could have a chilling effect. Our organizations need to be encouraged to talk to their city councilmen, to talk to their members of the county board, to speak to their Governors and to speak to their Members of Congress.

For instance, in Congress, the House just passed a very important program for voluntary agencies, the Urgent Relief for the Homeless Act. It provides $35 million for national agencies to allocate for the provision of shelter and food for the homeless.

We, as a national organization, supported that bill, and we're delighted the House passed it. Our local organizations are the ones that will implement the bill. I hope that the committee would see fit not to do anything that would in any way chill those kinds of efforts.

[The prepared statement follows:]

STATEMENT OF
JACK MOSKOWITZ
SENIOR VICE PRESIDENT, GOVERNMENT RELATIONS
UNITED WAY OF AMERICA
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
MARCH 12, 1987

Thank you for the opportunity to testify on the partnership role that the nonprofit community, and in particular local United Ways and their agencies, play in the delivery of human services to those in need. A number of voluntary agencies, including Catholic Charities, Family Service America and the YMCA, subscribe to the views that I will express today. A list of the organizations endorsing my testimony is attached.

There are more than 2,200 United Ways in the United States. Each is governed by a local board of volunteers whose job it is to determine the community's needs and to direct funds where the priority is greatest. In 1986, these local United Ways collectively raised more than $2.44 billion through voluntary contributions to fund local programs for child care, drug abuse treatment, services to the elderly and shelter for the homeless.

In the local communities in which we all live, the United Way agencies are often the mechanism through which the community reaches out to help those in need. Through these agencies the resources of government and private giving are combined to address community problems. An example of such cooperation can be found in the city of Austin, Texas. A group known as the Human Services Review Team, made up of representatives from the United Way, the school district, and the city and county governments, meets regularly to review the needs for social service funding in the area and to make their recommendations to the community's policymakers. Similar planning organizations exist in many communities across the country.

It is because of this critical inter-relationship that the dialogue between the voluntary agency and the government is so essential. And it is this essential dialogue that I want to talk about today.

Each of the voluntary agencies funded by the United Way is supported by the community to meet a particular need, whether that is the prevention of spouse abuse and the treatment of its victims or housing and other assistance for the mentally ill. Its volunteer energies and contributed dollars are devoted to fulfilling its particular charitable purpose as set out in its charter and defined by its volunteer board. Working with government at every level is a natural and inevitable part of carrying out this responsibility, small when measured in the dollars involved, but critical to the success of the organization's efforts.

Another example from the city of Austin illustrates my point. The United Way and the city and county governments jointly contract with the Salvation Army to operate a shelter for the homeless during the winter months. That shared responsibility requires a working relationship among the two governments, the Salvation Army and the United Way. And it imposes upon the United

Way of America the additional responsibility to lobby before this Congress for the funds necessary in Austin and across the country to provide for such shelters.

The Emergency Food and Shelter Program created in the 1983 Urgent Supplemental Appropriations Bill has proven to be a singular example of public/private partnership. Since its inception, $320 million has been distributed to local charitable shelters and food banks in all the states and territories providing approximately 338 million meals and 98 million nights' lodging. This undertaking was managed quickly, efficiently and at minimal cost. Checks were sent to local providers without delay, after the appropriation was received, within 30 days. Working with the Federal Emergency Management Agency, the National Board of voluntary agencies was able to formulate a current allocation to local communities on the basis of need. Local boards, composed of local voluntary charitable organizations with a local public official, made the allocation to provider agencies in an open process. Local community leaders, planners and agencies working with the poor participated in the decision making. Continued appropriations for this program would not have occurred without a United Way of America national lobbying effort. It is the basis for our support of the recently passed Urgent Relief for the Homeless Act.

I use this as an illustration because of its relevance to issues before you in this hearing: to what extent does a voluntary agency need to communicate with government? How does that communication take place, and is it consistent with the limitations on the activities of nonprofit charitable organizations contained in Section 501 of the Internal Revenue Code? These were questions widely debated during the years 1971-76. The debate led to the passage, as a part of the 1976 Tax Reform Act, of what are now sections 501(h) and 4911 of the Code. Those new sections were intended to clarify and expand the opportunities for voluntary agencies to work with government, to inform their members about the activities of government and to urge action by government on those concerns that their members identified as requiring action.

The legislation is founded on two principles. The first is the practical need that government has for the information and expertise of the voluntary agency. Who better than the Salvation Army to provide to local government the information required to understand the need for resources to provide shelter for the homeless? When the Commonwealth of Pennsylvania decided to establish standards for after school child care, it turned to the YMCA in Erie, Pennsylvania, which ran a model program, for help in developing those standards. The local voluntary agencies are doing the job in cities and counties across this country, and government at all levels needs to know what they are learning.

The second theme is that the voluntary agency, organized to carry out a charitable purpose, has an obligation to seek to further that purpose, to speak for its members and contributors as their advocate before government. Many human needs are unaddressed because they remain in the shadows, neither their cause nor their solution fully understood by the public or its policymakers. The voluntary agency must often be an educator before it can be a problem solver. One has only to look back over the last several decades to be reminded of the critical role of the voluntary agency in first identifying and then moving to solve the problems of the mentally ill, the substance abuser, the latchkey child or the homeless or hungry family. It is the citizen volunteer who sees the problem in his neighborhood or experiences it in his family who must raise the cry in the community. And it is to the voluntary agency that he turns to be his advocate in enlisting government to his cause. Neighborhood House operates day care and senior health care sites in Columbus, Ohio, including an unusual facility offering day care for parents who work the night shift. The information it provides to the local city council and to the state legislature about critical human service needs is an important part of its mission.

These two essential roles -- as expert and as advocate -- are at the heart of the necessity for the voluntary agency to take part in public policy debate. And it was to legitimize these roles that Congress passed the changes to section 501 in the 1976 Tax Reform Act.

What were these changes and what practical effect did they have? Public charities have always been permitted to lobby. Section 501(c)(3) of the Internal Revenue Code defines a public charity as, among other things, an organization "no substantial part of the activities of which is the carrying on of propaganda or otherwise attempting to influence legislation." However, the quantifying phrase "no substantial part" had never been further defined. An organization did not know how much it was in absolute terms nor what measuring stick to use. Was the test how much money you spent, how much time your staff and volunteers expended? Or was the test even more subjective, such as the level of importance your organization attached to the effort it was undertaking? These very practical questions caused many organizations to shy away from participating in the legislative process for fear of losing their tax exempt status.

In fact, during the late 1960's and early 1970's several organizations ran into trouble because of the vagueness of the law and the effort to clarify the lobbying rights of public charities was launched.

The 1976 legislation then reaffirmed the right of public charities to lobby, established an objective test based on dollars expended to determine the amount of lobbying permissible and, in response to the two underlying themes I discussed earlier, made clear that the voluntary organization, as an educator and advocate, could pursue certain critical activities without limitation.

1. Responding to a written request for testimony to a legislative committee or other governmental body. Right from the outset of the debate over the legislation it was recognized that government needed the information which the voluntary agency possessed because of its practical experience in the community. And government frequently called upon that agency to present that information and its views. In such cases the law did not impose any limitation on the agency in responding.

2. Presenting the results of nonpartisan analysis, study and research. Often the voluntary agency compiles the results of its experience and makes those studies available to the public and to policymakers. The Illinois and Chicago Agencies on Aging asked the United Charities of Chicago to provide information about the provision of health care to older family members in the home. As our population ages, more families are caring for older relatives. United Charities was asked to recommend what government could do to encourage such family care as a preferred alternative to institutional care, often state supported. In 1976, Congress encouraged the providing of such information by permitting it without limitation.

3. Communication with its own members. Recognizing that the strength of the voluntary agency and its value to the decision maker was in its role as an advocate for the active citizen, the 1976 legislation encouraged without limitation, the free flow of information and opinion between the voluntary agency and the citizens who were its members.

Having established these ground rules, Congress then concluded that in addition to these critical communications, there was a value in a democracy to having the voluntary agency present its views to the government whenever it believed such communication important to carrying out its charitable purposes. Not merely in response to an invitation, not simply in talking to its members, not only in the form of an objective study, but in straightforward advocacy of a cause. This activity -- lobbying in a more traditional sense -- was made subject to practical dollar limitations, consciously generous to permit it to occur in an unfettered way.

Why? Perhaps Russell Train, then Administrator of the Environmental Protection Agency, put it best in his testimony before this committee in 1976:

> Congress should be exposed to as wide a range of views as possible before enacting important environmental legislation ... [P]ublic charitable groups represent deeply-felt concerns of many of our citizens and I believe access to the legislature should be available to all interested groups.

Much of this activity goes on today as it did then, in city councils, before school boards, and at the annual gatherings of state legislatures. It is the free flow of ideas and opinions between the individuals elected in our society to make the hard choices and the volunteer spirit in the communities that they represent. This quiet dialogue does not seek the headlines or get on the evening news. But it is this dialogue that the 1976 Tax Reform legislation sought to nourish and encourage. It is this dialogue and the partnership between government and the voluntary sector that it creates that is solving the very real and very human problems that exist in our society.

The following organizations endorse this statement:

Affiliated Leadership League of and for the Blind of America
American Foundation for the Blind, Inc.
American Red Cross
Arthritis Foundation
Boys Clubs of America
Camp Fire, Inc.
Catholic Charities USA
Child Welfare League
Council of Jewish Federations, Inc.
Family Service America
Goodwill Industries of America, Inc.
National Alliance for the Mentally Ill
The National Assembly
United Cerebral Palsy Association, Inc.
United Neighborhood Centers of America, Inc.
YMCA of the U.S.A.
YWCA of the U.S.A.

Chairman PICKLE. Thank you very much, Mr. Moskowitz. And I thank each one of you, because you've made good statements, and you may be reasonably prejudice on behalf of your own groups. At least you're united in your efforts here. This is really the united effort instead of the United Way.

I think I'll just ask one or two questions. Are each one of you 501(c)(3)? Anybody different than 501(c)(3)? That is true for all?

Do any of you, although you operate as 501(c)(3), do any of you or any of your groups operate as 501(c)(4)?

Mr. HUDSON. Yes, sir, Mr. Chairman.

Chairman PICKLE. How many of your organizations are (c)(4)?

Mr. HUDSON. At least at People for the American Way an affiliated (c)(4) is involved. The Children's Defense Fund has had one. I think it has been disbanded to the best of my knowledge. I would have to check on that.

Chairman PICKLE. Well, then, only one or two of your groups are (c)(4).

Mr. HUDSON. Yes, sir. And in the coalition there are a number of others that are (c)(4).

Chairman PICKLE. All right.

Now, Mr. Moskowitz, in your case, you represent the American Cancer, is that your organization?

Mr. MOSKOWITZ. No. I represent the United Way.

Chairman PICKLE. All right, United Way.

Mr. MOSKOWITZ. And their associated agencies.

Chairman PICKLE. What amount of money does United Way raise nationally on a yearly basis? What's your annual budget, we'll say for a year, just roughly?

Mr. MOSKOWITZ. Local United Ways raised last year $2.44 billion.

Chairman PICKLE. $2.4 billion, and that includes the money you raised, and salaries for your people and the disbursement of funds and so forth.

Mr. MOSKOWITZ. That is correct. If I can explain that just where that money comes from——

Chairman PICKLE. That's all right, I'm just trying to get an estimate.

Mr. MOSKOWITZ. Local United Ways are the ones who raise it, they're the ones who allocate it. The cost of that fundraising effort runs between 8 and 11 percent. The balance of that money goes to services.

Chairman PICKLE. All right.

Now, let me just get one other example, the American Cancer Society.

Dr. FREEMAN. Yes, Mr. Chairman.

Chairman PICKLE. What is your budget annually?

Dr. FREEMAN. Our average budget annually is in the range of $270 million.

Chairman PICKLE. Million?

Dr. FREEMAN. Million, yes.

Chairman PICKLE. That would be a little heavy if it went up to a billion, wouldn't it, $270 billion.

Dr. FREEMAN. No, no, $270 million.

Chairman PICKLE. Mr. O'Connell, I have your statement here. I don't know where I put it now, but I'm in general agreement with what you're saying. You state that you ought to be able to lobby and when we find that there are violations or infringements or abuses, the Congress or the Internal Revenue Service ought to take action and stringently be certain that organizations abide by the law.

You also point out, for instance, that if any of the money from the sale of arms or equipment to Iran could be traced back to a foundation which used the money to oppose candidates, Democrats or Republicans in say, the Congress; that that ought to be disallowed.

Mr. O'CONNELL. And prosecuted.

Chairman PICKLE. And prosecuted. Not only that, they ought to be thrown in jail, it would be the most reprehensible thing that could ever develop. So, I don't think you and I, and I'm sure the others, have much disagreement that we've got the law and it ought to be abided by. If it isn't, then we ought to have some prosecution and weed out these people who are flaunting the law, so to speak.

Now, as I take it, you people want the 501(c)(3) designation, and want the IRS to watch it to see that organizations obey the law. Section 501(c)(3) says that you can lobby, so long as it's not substantial. But, you want to get rid of the substantial rule and just allow lobbying without any control, basically. Am I stating it correctly?

Mr. O'CONNELL. No, sir.

Mr. TROYER. No.

Chairman PICKLE. Now, you all want to be able to lobby without any kind of control.

Mr. O'CONNELL. No. Mr. Chairman, the 1976 law provided that charitable organizations can elect to come under the accountable provision. But even that——

Chairman PICKLE. All right, let me ask you. Did you elect?

Mr. O'CONNELL. Yes, we did, sir.

Chairman PICKLE. Did all of you elect to come under the 501(h)?

Mr. MOSKOWITZ. United Way of America has elected, and we've encouraged our local United Ways to elect because of the definition and the exceptions I discussed. I don't know how many have. But to answer your question, Mr. Chairman, we don't believe that there is a right to unlimited lobbying.

We're, as I said before, satisfied with the 1976 law. As was pointed out here, the 1976 law was well thought out and subjected to congressional discussion for a period of 7 years.

Chairman PICKLE. Well, now, this committee——

Mr. MOSKOWITZ. We support the 1976 law and it does have limitations, Mr. Chairman.

Chairman PICKLE. Mr. Moskowitz, this committee is not recommending to repeal the 1976 law. I assume you're just speaking against repeal in fear that we might want to consider it. That's your prerogative.

Mr. MOSKOWITZ. Really in my heart I didn't think you would, Mr. Chairman, I just wanted to make sure that you know that I——

Chairman PICKLE. I don't want to let the record show that you were expressing a concern that we might go and repeal this law. We have made no recommendation for doing that. I just don't want to let that be the lead thought, that we're trying to do that, because that's not the case. All of you have not elected to go under this 501, what is it, (h)? You have elected to do that only in a very few instances. I guess really you're just trying to send a signal down to the Internal Revenue Service not to issue those new regs, that you are afraid that they might slow you down in what you're doing now. Is that right?

Mr. O'CONNELL. We're also sending a tough message in the context of this hearing, and with all due respect, we're taking the gamble of being a bit critical of Congress.

Its been my experience over many years, Mr. Chairman, that when something as despicable as seems to be occurring in the use of nonprofit organizations and arms, and using that money to get involved in campaigning against Members of Congress, that the immediate response, understandable and human is, let's tighten the law.

And what I'm suggesting is that I think more of the energy, more of the anger, more of the outrage, and appropriate outrage should be going to get those rascals.

Chairman PICKLE. Well, Dr. Freeman, you have a budget of $275 million, and then you said, we ought to be able to use, I assume, that sum of money "for lobbying purposes."

Dr. FREEMAN. No. No, sir, I did not say that.

Chairman PICKLE. All right, I want to clear that up. You're willing to abide by the "substantial rule."

Dr. FREEMAN. We did not elect to change over, although we supported the new—the 1976 legislation. Our lobbying budget is about 0.51 percent of the total budget. We—it's such a small consideration within our budget; well, less than a million dollars a year, that we ~~like~~ to just stay as we were.

Chairman PICKLE. I guess in my own mind, I'm just simply trying to clarify this myself. You had a budget of $275 million, and United Way had a budget of $2.4 billion. Suppose you wanted to do more lobbying, for the public good in many respects, and certainly from your viewpoint at least. All that money could be used for perhaps good purposes; but it also poses a concern for the Congress, I guess, or State legislatures. It might be that, if you had that much money, your expenditures would be for the purposes of influencing legislation or getting more money for certain programs. I don't care whether it's for early detection of cancer, or to examine the relationship between tobacco and cancer, or what other objective there might be. If you had that kind of fund to be spent totally against the legislative body, then it would create a problem for that legislature to be, say, fair to other groups who can't spend that. I take it now, as a matter of clarification, however that you're not recommending a change in section 501(c)(3). You're willing to stay with the substantial rule, and maintain the option under the 501(h).

All right. I thank you very much.

Dr. FREEMAN. That is correct.

Mr. MOSKOWITZ. That's correct. For the United Way, that is correct, Mr. Chairman.

Chairman PICKLE. Mr. Jacobs, do you have any questions?

Mr. JACOBS. No questions, Mr. Chairman.

Chairman PICKLE. Mr. Anthony.

Mr. ANTHONY. No questions, Mr. Chairman.

Chairman PICKLE. Well, I thank you. I think we could talk at length about your objectives. I don't want anybody to think that we would encourage United Way, the Cancer Society, the Girl Scouts, the Boy Scouts to not lobby "for the public good." Because if we didn't allow you to make such expenditures, I think that means the Federal Government would have to be making more expenditures.

So, there's a great deal of good to be done. What we're trying to find is, do we have definitions that really determine what is lobbying and what isn't; what is substantial and what isn't substantial? Maybe the 1976 act should be maintained, in essence, like it is.

We're not trying to make changes to that act. That's not our objective.

So, I thank you panelists very much.

Now, we have one more panel. Norma Phillips, Betty Williams, Alan P. Dye, and John Johnson.

Our panel is composed first of Norma Phillips who is president of Mothers Against Drunk Driving. Ms. Phillips, will you hold up your hand.

Betty Williams, the director of public affairs for the Indiana Planned Parenthood Affiliated Association. Ms. Williams.

Mr. Alan P. Dye, who is counsel to the Council on Non-Profit Organizations. Mr. Dye.

And then, Mr. John W. Johnson, executive vice president of American Collectors Association, and chairman of the board of the American Society of Association Executives. That's all the trade organizations in the country. A good organization. We're glad to have you here. And I'm glad to have all of you.

Now, Ms. Phillips, I'm going to ask you, is it Miss or Mrs. Phillips?

Mrs. PHILLIPS. Mrs.

Chairman PICKLE. Mrs. I'm going to ask you to proceed first. I also understand that you have a plane reservation that you want to make, and since the plane reservation, I assume, is to go back to Texas, I wouldn't want you to miss that at all. If during the discussion your time runs short and you have to leave, we'll understand if you have to leave the table. But we'll start off with your testimony. We're glad to have you.

STATEMENT OF NORMA PHILLIPS, NATIONAL PRESIDENT, MOTHERS AGAINST DRUNK DRIVING

Mrs. PHILLIPS. Thank you, Mr. Chairman.

As a 501(c)(3) nonprofit tax-exempt organization, Mothers Against Drunk Driving relies very strongly on our grassroots efforts to implement a public awareness campaign about the hazards of drug and drunk driving.

Our volunteers, on a nationwide basis, support public policies, stringent law enforcement, and vigorous prosecution of DWI crime throughout the criminal justice system.

Our organization, rather than utilizing paid professional lobbyists depends upon the strength of its grassroots volunteers to educate, advise, counsel and inform the public and the lawmakers concerning impaired driving issues, and the need for adequate laws against such crimes.

It is the very volunteer nature of our organization that has been the key to the wide spread success and recognition throughout America.

MADD has almost 400 local chapters in the United States. And we seek to accomplish our legislative goals. The overwhelming majority of our legislative efforts occur at the state level; whether the issue pertains to a ban on open containers of alcoholic beverages in motor vehicles, establishing 21 as the legal drinking age, or the passage of server liability statutes, and any other number of DWI countermeasures, MADD stands at the forefront of these issues and involvement.

We have been effective. Since MADD's inception in 1980 over 700 countermeasures in all the States have been passed and put on the books. And I think that's quite an achievement for any organization to have a major part in.

MADD is thoroughly dependent upon its volunteer citizen activists to accomplish the task at hand. By relying on the grassroots strategy MADD remains well under established limits on expenditures for lobbying purposes.

In accordance with the current IRC 501(h) requirements governing the nonprofit organization, our organization has elected to limit such costs to a percentage of exempt purpose expenditures. It is a standard with which we remain in full compliance. And one that we support as a means of clearly defining our activist roles, under the 501(c)(3) nonprofit tax-exempt provisions.

Mothers Against Drunk Driving urges that the present longstanding definition for lobbying for nonprofit organizations be retained and clearly aimed at only those specified actions to influence legislation.

By allowing Mothers Against Drunk Driving to operate within current legal parameters, our organization can continue its war against alcohol and drug impaired driving, and help assure greater safety on America's streets and highways.

And I would like to conclude by saying that drunk drivers do not discriminate either. It doesn't matter which political party; there are victims everyday. In fact, 62 people die each day in our Nation because of drunk driving.

We, as an organization, have reduced fatalities every single year. And as a mother who is a victim, also, I would like to thank the committee for allowing Mothers Against Drunk Driving to be heard today.

[The prepared statement follows:]

Statement by Norma Phillips, National President,
Mothers Against Drunk Driving

Presented to the U.S. House of Representatives
Ways and Means Subcommittee on Oversight

March 12, 1987
Washington, D.C.

As a 501(c)(3) nonprofit tax exempt organization, Mothers Against Drunk Driving relies upon a broad based grass roots effort to implement a public awareness campaign against alcohol- and drug-impaired driving. As part of this effort, MADD volunteers on a nationwide basis advocate corresponding public policies, stringent law enforcement and vigorous prosecution of DWI crime through the criminal justice system.

MADD, rather than utilizing paid professional lobbyists, depends upon the strength of its grass roots volunteers to educate, advise, counsel and inform the public and their lawmakers concerning impaired driving issues and the need for adequate laws against such crimes. It is the voluntary nature of MADD that has been the key to its widespread success and recognition throughout America. MADD has almost 400 local chapters in 48 states through which we seek to accomplish our legislative objectives.

Our cause has enlisted the aid and support of over 600,000 individuals nationwide. Many of these citizen activists work with their elected representatives at all levels in order to freely express their needs and concerns regarding public policy initiatives against drunk and drugged driving.

The overwhelming majority of our legislative efforts occur at the state level. Whether the issue pertains to a ban on open containers of alcoholic beverages in motor vehicles, establishment of 21 as a legal drinking age, the passage of server liability statutes, or any number of other DWI countermeasures, MADD stands at the forefront of involvement.

The federal level presents an additional avenue through which MADD has found legislative support. This was exemplified by congressional enactment last year of permanent highway funding sanctions for states without a minimum drinking age law. At whatever level, MADD makes itself heard, not as a self-serving organization, but as the voice of concerned citizens and victims who have a deep-seated desire to put a final end to the tragedy of DWI crime.

We have been effective. Since MADD's inception in 1980, over 700 anti-drunk driving state laws have been put on the books. That is quite an achievement for any organization to have a major part in; but the job is far from complete. At least 22,360 alcohol- or drug-related traffic fatalities still occur annually and another 541,000 individuals are injured. In addition, the drunk driving problem creates a yearly economic loss to American taxpayers in the billions of dollars.

MADD is thoroughly dependent upon its volunteer citizen activists to accomplish the task at hand. By relying upon this grass roots strategy, MADD remains well under established limits on expenditures for lobbying purposes. In accordance with current IRC 501(h) statutory requirements governing nonprofit groups, our organization has elected to limit such costs to a percentage of exempt purpose expenditures. It is a standard with which we remain in full compliance, and one that we support as a means of clearly defining our activist role under 501(c)(3) nonprofit tax exempt provisions.

Mothers Against Drunk Driving urges that the present long-standing definition of lobbying for nonprofit organizations be retained and clearly aimed at only those specific actions to influence legislation. By allowing MADD to operate within current legal parameters, our organization can continue its war against alcohol- and drug-impaired driving and help assure greater safety on American streets and highways.

Norma Phillips
National President
Mothers Against Drunk Driving

Chairman **Pickle**. Thank you, Mrs. Phillips. I would like to observe that your organization serves a very useful purpose, and we wish you well.

Mrs. **Phillips**. Thank you, Mr. Chairman.

Chairman **Pickle**. Now we will hear from Betty Williams, director of public affairs for the Indiana Planned Parenthood Association.

STATEMENT OF BETTY WILLIAMS, DIRECTOR OF PUBLIC AFFAIRS, INDIANA PLANNED PARENTHOOD ASSOCIATION, BOARD MEMBER, INDIANA COALITION FOR HUMAN SERVICES

Ms. **Williams**. Thank you, Mr. Chairman.

I am connected with Indiana Planned Parenthood Affiliates Association, but today I am speaking as a board member of the Indiana Coalition for Human Services.

The Coalition for Human Services is an organization of 33 organizations working to develop and promote comprehensive human services for Indiana residents by influencing public policy and its implications. Emphasis is given to human services which benefit low income and high risk persons.

A list of the members is attached to the written copy of my statement.

The coalition is incorporated as a 501(c)(4) not-for-profit organization. However, most of its member agencies are tax exempt under 501(c)(3) IRS rulings. The member agencies have abided by the limits of the 1976 Tax Reform Act but are now concerned about the effect of the proposed new IRS rules on lobbying by public charities, especially on the small agencies that represent the most vulnerable segments of our society. Each of the members of the Indiana Coalition for Human Services will be affected in a different way, so I can only speak generally.

We are all concerned that the proposed rules are difficult to interpret and that they contradict the major objectives Congress addressed in the 1976 Tax Reform Act. Congress apparently recognized the benefits of the legislative process of allowing the flow of information from nonprofits to their members and legislators. We believe the act was intended to remove uncertainties about the kind and amount of lobbying that is permitted and to correct the unfair imbalance of lobbying interests that existed.

The expansion of the definition of lobbying to include communication with legislators and the public prior to the existence of imminent or contemplated action will stifle useful communication. In fact, if adopted, we fear the proposed rules will eliminate the means by which ordinary citizens who make up the membership of nonprofit organizations can be informed and thus able to participate in the public policy decisionmaking.

In Indiana the coalition member agencies frequently give testimony in legislative study committees, committees charged with determining if there is a problem and if legislative action is needed. There are only 18 professional researchers available to our 150-member general assembly. They cannot possibly research all areas of concern to our legislators. The information received from lobbying organizations is not only important to these study committees;

it is critical. The Indiana Legislature supports this need. They have under consideration a resolution which reads, in part:

> Whereas the research and analysis provided by these non-profit organizations is important to informed decision-making in our state; and whereas state legislators value the information and feedback provided by charitable organizations in our state; therefore, be it resolved by the Senate of the General Assembly of the State of Indiana, the House of Representatives concurring, that the General Assembly of the State of Indiana urges the Commissioner of Internal Revenue to withdraw the proposed rules on lobbying by public charities.

It is of additional concern that providing research information to the media could be considered grassroots lobbying. Reporters attend study committees and frequently want statements or copies of research from those who testify to include in their newspaper, radio or TV reports. Inhibiting this flow of information denies the public its need and right to know guaranteed under the first amendment.

We believe that communication is vital in a democratic society. The proposed rules may have the effect of limiting information to the public when nonprofits are forced to choose between losing their tax exempt status and disseminating information through their newsletters. Certainly it is not a good precedent to discourage the flow of information.

Fundraising by nonprofits could also be affected if legislative issues must be avoided in order to keep the tax exempt status. People are frequently moved to make contributions when they are informed that a problem exists. We could be faced with a catch-22 situation, lose the 501(c)(3) status because we exceed the 5 percent lobbying limit, or lose contributions because we cannot use information in fundraising requests that encourages giving.

Our member agencies are already experiencing some reluctance from foundations to contribute to them because of the way the proposed rules involve foundations in the action of their grantees. Certainly if foundations do make grants to nonprofit groups, they will require new accounting and reporting as foundations seek to protect their own tax exempt status, thus increasing the cost to the grantees.

The proposed IRS rulings leave many questions. They appear certain to have a chilling effect on fundraising and information gathering and dissemination by nonprofit agencies which are trying to promote the public good.

We believe that these rules should be withdrawn and new regulations developed in consultation with those who will be affected. If the IRS does not withdraw the rules, the member agencies of the Indiana Coalition for Human Services urge Congress to prohibit implementation of the rules.

We thank you for this opportunity to address you concerning this most important issue.

[Attachments to the statement follow:]

INDIANA GENERAL ASSEMBLY

A CONCURRENT RESOLUTION urging the Commissioner of Internal Revenue to withdraw the proposed rules on lobbying by public charities.

WHEREAS, Congress amended the federal Tax Code in 1976 to help and encourage charitable groups to get involved in government decision-making by allowing them to use a percentage of their resources to do legislative advocacy; and

WHEREAS, The Internal Revenue Service is proposing rules on lobbying by public charities which would severely curtail their involvement in the legislative process and in public policy research; and

WHEREAS, The research and analysis provided by these nonprofit organizations is important to informed decision-making in our state; and

WHEREAS, State legislators value the information and feedback provided by charitable organizations in our state: Therefore,

BE IT RESOLVED BY THE SENATE OF THE GENERAL ASSEMBLY OF THE STATE OF INDIANA, THE HOUSE OF REPRESENTATIVES CONCURRING:

SECTION 1. That the General Assembly of the State of Indiana urges the Commissioner of Internal Revenue to withdraw the proposed rules on lobbying by public charities.

SECTION 2. That this General Assembly encourage the IRS to consider establishing an Advisory Committee which would include public charities and private foundations to develop fair and reasonable regulations that are consistent with the intent of the 1976 Tax Reform Act.

SECTION 3. That the Secretary of the Senate is directed to transmit official copies of this resolution to the Commissioner of the Internal Revenue Service, to the leadership of both houses of Congress of the United States and to the Congressional delegation of the State of Indiana.

INDIANA COALITION FOR HUMAN SERVICES
Membership List

Community Service Council of Metropolitan Indianapolis, Inc.

Council of Volunteers and Organizations for the Handicapped in Indiana, Inc.

Delaware County Coalition for Human Services
Episcopal Diocese of Indiana

Family and Children's Center, Inc.

Family Service Association of Indianapolis

Human Service Action Coalition of Tippecanoe County

Indiana Association of Area Agencies on Aging Directors, Inc.

Indiana Association of Home Service Agencies, Inc.

Indiana Association of Home Health Agencies

Indiana Association for Retarded Citizens

Indiana CAP Directors Association, Inc.

Indiana Catholic Conference

Indiana Conference on Social Concerns

Indiana Council of Churches

Indiana Council of Community Mental Health Centers, Inc.

Indiana Council of Family Service Agencies

Indiana Council on Family Relations

Indiana Hospital Association

Indiana Interreligious Commissison on Human Equality

Indiana Planned Parenthood Affiliates Association, Inc.

Indiana Retired Teachers Association

Indiana State Teachers Association

Indiana University School of Social Work

Indiana Youth Services Association, Inc.

Indianapolis Urban League

Jewish Community Relations Council

League of Women Voters of Indiana

Mental Health Association of Indiana

Monroe County Community Forum

National Association of Social Workers, Indiana Chapter

National Council of Jewish Women, Indianapolis Section

Salvation Army, Indiana Division

Mr. **Anthony** [presiding]. Thank you, Ms. Williams.
Mr. Dye.

STATEMENT OF ALAN P. DYE, COUNSEL, COUNCIL ON NON-PROFIT ORGANIZATIONS, INC.

Mr. **Dye**. Thank you for inviting us to testify before the subcommittee. I represent the Council on Non-Profit Organizations, which is an ad hoc coalition of nonprofit organizations, including charities such as the National Center for Missing and Exploited Children and the National Child Safety Council, educational research organizations, think tanks, if you will, such as the Free Congress Foundation and the Liberty Federation, and lobbying organizations such as the Liberty Alliance and Coalitions for America.

I am in the happy position of agreeing with most of what I have heard on the last couple of panels. Specifically, I agree with Mr. Lehrfeld that the more debate we have on public policy issues, the better off we all are, and that sometimes the people best qualified to debate the issues are nonprofit organizations across the political spectrum.

I would endorse Mr. Lehrfeld's recommendation of repeal of the lobbying prohibition entirely except that the revenue impact of that probably makes it infeasible.

I also agree with most of the other panelists on the last two panels that the law works reasonably well, particularly as amended in 1976. However, it certainly is desirable to have some clarification of the definitions that are used; as it is very difficult as counsel to organizations engaged in public policy research.

In general such organizations are quite conscientious in avoiding substantial legislative activity. Typically they consult counsel regarding anything which appears to them at all possible to raise a question, and they take counsel's advice. It is very difficult when given something like that as counsel to such an organization to be able to interpret properly what the statute means. The definition of what is lobbying, particularly in terms of white papers and so on produced by clients, is fairly vague.

I think the IRS is working to clarify those things. I am not sure legislation is necessary to do that. If legislation is considered on other grounds, certainly clarification is one of the things which should be sought. One of the things which should not be sought is anything which further restricts the ability of these organizations that contribute so effectively to the public debate to do so.

I don't intend to go through specifically the recommendations which we made in our statement.

Thank you for your invitation.

[The prepared statement follows:]

STATEMENT

Submitted on behalf of

The Council on Non-Profit Organizations, Inc.

by

Alan P. Dye, Esq.
Counsel

LOBBYING AND POLITICAL ACTIVITIES BY NON-PROFIT ORGANIZATIONS

The Council on Non-Profit Organizations (The Council) is pleased to present this statement for the record of the March 12 and 13, 1987 hearings of the Subcommittee on Oversight, Committee on Ways and Means, United States House of Representatives, in connection of its examination of lobbying and political activities by non-profit organizations. The Council is a newly formed coalition of charities, lobbying groups, and other non-profit organizations whose concerns include laws governing lobbying by such organizations, as well as the rules governing the taxation of business income which will be the subject of this Subcommittee's hearings in late April.

Current State of the Law

Other witnesses have discussed in detail the specific statutory and regulatory provisions relating to lobbying and political activities by the various types of tax-exempt organizations. It is unnecessary for us to repeat this description. What I have been asked to do by the members of the Coalition is to discuss with you the problems faced by counsel to such organizations in giving them clear guidance as to what is permissible, and, with respect to legislative activities, how much is appropriate.

The Legislative Prohibition

The limitation of grass roots and direct lobbying to an "insubstantial part" of the activities of a section 501(c)(3) organization inhibits the activities of such organizations in several ways. Most importantly, great uncertainty exists concerning what kind of activity constitutes lobbying and how the amount of lobbying is measured. The greatest uncertainty surrounds so-called "grass roots lobbying," defined as attempts to influence the general public (or any part of the public, such as an organization's members) with respect to legislation.

The Internal Revenue Service takes the position that a communication is intended to influence legislation if it "reflects a view with respect to that legislation", unless it meets one or another of the exceptions that are applicable. Many charitable organizations are sufficiently concerned that they refer publications to counsel prior to distribution. Counsel must read the work, often a scholarly analysis of a public policy issue or legislation, make a determination whether it reflects a view with respect to a legislative issue, and if necessary, propose revisions and deletions so that the material does not pose a threat to the tax-exempt status of the entity conducting the analysis.

Most counsel take a conservative view with respect to these issues. This results in suggestions for amendments and deletions that often seriously reduce the value of the analysis.

If it is desirable in a pluralistic society such as ours to encourage the maximum degree of analysis of public issues by persons and organizations which span the political spectrum, the present law poorly serves that end. Though the hearings leading up to the enactment of Internal Revenue Code section 501(h) in 1976 indicate that it was Congress' intention to encourage charities to take part in the debate on important issues of public policy, the lack of certainty in present law continues to inhibit such participation.

Other IRS interpretations are even more destructive. For instance, at some point, the Service developed the concept that a communication could be deemed to reflect a view with respect to an issue or a candidate even though its presentation is completely balanced, unbiased, and nonpartisan, if the communication is "selectively disseminated" to persons sharing a common view with respect to the issue or the candidates. This concept has appeared in regulations under section 4945, and recently in proposed regulations under section 501(h). The application of this concept compels the charity not only to insure that its analyses of issues are nonpartisan and unbiased in content, but also to inquire in some way with respect to the views of the persons receiving the communication. Because publications of educational organizations are often distributed to a mailing list made up of contributors, as well as others who request the information, this is unreasonably burdensome. If, as is commonly the case, however, those who contribute or request information share the views of the organization, the predominant distribution may well be to persons sharing a common view. In such an instance, under the IRS view, the dissemination of a completely unbiased, scholarly, analysis of an issue which draws no conclusion with respect to that issue would be considered a legislative communication subject to the substantiality limitation.

The definition of a legislative communication is also insufficiently clear. Obviously, a communication which specifically mentions a bill number or otherwise refers to specific legislation and encourages support and/or opposition must be considered a legislative communication. The Service has also taken the position, however, that discussion of an issue that is the subject of legislation or that is likely to become the subject of legislation in the near future may be considered a legislative communication, even if it makes no specific reference to the legislation. In light of the fact that there are thousands of bills introduced in the U.S. Congress alone and tens of thousands into state legislatures, city councils, and other legislative bodies, it is difficult to imagine any public policy issue which is not likely to be the subject of legislation. Thus, communication by an educational organization relating to a subject of legitimate interest, but not referring to any specific legislation, may be considered by the IRS to be a communication subject to the substantiality test.

Substantiality

The other difficulty in the prohibition on lobbying is determining how much is too much. An organization not electing under section 501(h) may not engage in substantial legislative activity. What is "substantial" has never been defined. The Internal Revenue Service has never even been willing to agree on a method for measuring the substantiality of an activity. Some courts have attempted to quantify the amount of activity as a percentage of the organization's total activities. Others have rejected this approach. The IRS has indicated that it will examine each case on its own merits, perhaps using different tests, depending on the circumstances. All of this led to the enactment of section 501(h), providing an elective alternative for most section 501(c)(3) organizations. Section 501(h) has, however, been totally ineffective. Less than 1% of the eligible organizations have elected, in part because the IRS has not issued final regulations under the provision. In light of the extreme stringency of the proposed regulations recently issued under section 501(h), it is unlikely that this percentage will increase.

Political Activity

Section 501(c)(3) absolutely prohibits direct or indirect participation or intervention in any political campaign on behalf of or in opposition to any candidate for public office. This rule is absolute, and therefore lacks the uncertainty of the substantiality test. However, it does have the same uncertainty as to the definition of the prohibited activities. Many organizations involved in public policy research publish frequent articles and reports with respect to issues and legislation. Many of these articles mention public officials who are addressing these issues or identified with (or against) legislation. If these officials are candidates for public office, as is often the case, discussion of the issues which favorably or unfavorably reflects upon the candidates' positions on the issues may be taken as intervention in a political campaign. Again, this uncertainty stifles the ability of public policy research institutions to freely discuss issues, as is necessary if they are to fulfill society's need for free and open debate.

Other specific problems include inconsistency between tax law and election law, the use of a charitable organization's facilities by a political candidate, and distinguishing between the personal and employment-related activities of employees of charities who volunteer their services to political campaigns.

The Section 501(c)(4) Alternative

Section 501(c)(4) of the Code serves as a safety valve from the uncertainties involved in section 501(c)(3). Many organizations, concerned about the uncertainty of the definitions and quantity limitations with respect to section 501(c)(3), establish an affiliated section 501(c)(4) organization. Expenses and activities are allocated, and legislative and political activities are carried on by the section 501(c)(4) organization and paid for out of its treasury, thus eliminating the threat to the exemption of the related section 501(c)(3) organization. Generally, this system works well and should not be altered. There is no policy justification for prohibiting affiliation by section 501(c)(3) and 501(c)(4) organizations. Indeed, the establishment of such organizations effectuates what seems to be the congressional intent to insure that tax-deductible funds are not used for political activity or substantial lobbying.

Recommendations

1. Eliminate the section 501(c)(3) limitations on grass roots lobbying communications, except for express advocacy of specific legislation. This will eliminate the greatest uncertainties in this area. As a result, fewer publications by exempt organizations will be required to be pre-reviewed by counsel, and a more free and more productive public debate will take place. The same position should be taken with respect to the "action organization regulations." Treasury Regulation §1.501(c)(3)-1(c)(3). A communication should be deemed educational so long as it does not urge its reader to take some legislative action with respect to specific legislation.

2. Limit the definition of intervention in a political campaign to communications or other activities expressly supporting or opposing a candidate or party. This would allow charitable and educational organizations to discuss public policy issues which involve public officials without fearing loss of tax-exempt status, so long as the communication takes no position with respect to whether the reader should support or oppose a candidate.

3. Specify the quantity of legislative activity deemed to be "substantial" for non-electing organizations and define how the "substantiality" of an activity is to measured. "Substantiality" should be measured in the clearest and simplest way, by the percentage of expenditures devoted to the activity.

4. Specify that section 162, section 527, section 501(c)(3) and section 501(h) are intended to be consistent with each other and with the Federal Election Campaign Act of 1971. Thus any action that would not be considered a contribution or expenditure for Federal Election Campaign Act purposes should not be considered an "exempt function expenditure" or "participation in any political campaign" for purposes of section 527 or section 501.

5. Specify that the determination of whether a communication by a charitable organization is to be considered a political or legislative communication will be based entirely upon the content of the communication and will in no way be based upon the identities or views of those who receive it.

Mr. ANTHONY. Thank you, Mr. Dye.

Mr. Johnson.

STATEMENT OF JOHN W. JOHNSON, CAE, EXECUTIVE VICE PRESIDENT, AMERICAN COLLECTORS ASSOCIATION, CHAIRMAN OF THE BOARD, AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

Mr. JOHNSON. Thank you, Mr. Chairman and members of the committee.

I have a statement that runs about 4 minutes. I would like to read it, if I may, and then I would be happy to respond to any questions.

My name is John Johnson. I am the executive vice president of the American Collectors Association located in Minneapolis. ACA is a not-for-profit trade association with more than 3,300 corporate members who provide debt collection services for approximately 800,000 credit grantors in the United States and abroad.

I also serve as chairman of the board of the American Society of Association Executives based in Washington, DC. This organization, known as ASAE, is an individual member society representing 14,000 executives who manage nearly 7,000 trade or professional associations in the United States and abroad. ASAE was founded in 1920 with just 67 charter members. Today we have an overall constituency—and this means members of the member associations—of more than 80 million individuals and businesses.

ASAE welcomes the Oversight Subcommittee's review of the lobbying and political activities of tax-exempt organizations. ASAE recognizes that a comprehensive review of such activities and the tax rules applicable to them is warranted given that some of these rules date back to 1934.

It is also evident that better information is needed on the nature and extent of lobbying and political activities carried on by section 501(c) groups. Given the increasing concern in this country over the high cost of political campaigns and the role of political action committees and so forth, it is clear that tax-exempt organizations cannot and should not escape scrutiny.

So we agree wholeheartedly that taxpayers ought to be assured that organizations enjoying tax exempt status are indeed operating for the public benefit.

I would like to emphasize that if your findings indicate some tax exempt groups are undertaking lobbying or political activities inappropriate to their tax exempt purpose, ASAE would fully support proper remedial measures. At the same time, we believe your findings will show that the overwhelming majority of associations are operating within the law and according to their tax exempt purpose.

If any group is abusing its favored tax status, ASAE would urge the Internal Revenue Service to revoke that organization's exemption or take other measures that may be appropriate.

In keeping with our objective of member service, ASAE prepares and makes available studies on various aspects of association management. I would like to bring several pertinent statistics from these studies to the committee's attention. Incidentally, the association's staff and activities are fully available to members of the committee in gathering additional statistics in this area.

First of all, ASAE's 1985-86 Association Operating Ratio Report indicates that the average association spends less than 5 percent of its budget on Government relations activities. Two-thirds of associations do not even employ a full-time staff person to engage in Government relations activities.

This information corresponds very closely with that collected through the IRS Exempt Organizations Business Master File indicating that less than 1 percent of tax exempt organizations appear to engage in lobbying or political activity.

All available data point to the conclusion that the vast majority of tax exempt organizations fulfill their primary educational or business function without engaging in inordinate lobbying or political activity. With regard to the latter, only 13 percent of associations report that they operate a political action committee on the Federal level.

ASAE's findings support the contention that association political action committees are extremely broad-based, that contributions to these PAC's come from a diverse cross section of the American public. A typical association PAC receives an average contribution of $116 from over 3,000 individuals who believe in the efficacy of our campaign financing system.

To summarize, Mr. Chairman, ASAE believes the tax exempt organizations serve the public interest. Indeed, they have been accorded tax exempt status in recognition of the valuable role they play in our society. They are not, strictly speaking, special interest groups. The overwhelming majority does not exist solely to lobby, to elect a candidate or to pursue a political agenda. On the contrary, the rather limited public policy activities remain subordinate to their tax exempt purpose.

To our knowledge, the data gathered by the Internal Revenue Service, General Accounting Office and the private organizations support this conclusion.

ASAE appreciates the Oversight Subcommittee's review of the lobbying and political activities of tax-exempt organizations. We understand the concerns that have been expressed in recent years over the growth of political action committees and the influx of millions of dollars into political campaigns. However, we would urge the distinguished members of the subcommittee to verify the legitimate role of trade and professional associations in the public policy process. We also urge the IRS to identify any abuses of an organizations's tax exempt status and exercise appropriate compliance measures. Most importantly, ASAE believes that changes in the current law are unwarranted, and we stand ready to assist the Oversight Subcommittee in separating fact from fallacy. We offer ASAE's considerable resources and those of our members in helping to clarify associations' lobbying and political activities.

Mr. Chairman, I want to thank you and the members of the subcommittee and your subcommittee staff as well for this opportunity to testify on behalf of the American Society of Association Executives.

Thank you.

[The prepared statement follows:]

STATEMENT OF JOHN W. JOHNSON, CAE
EXECUTIVE VICE PRESIDENT, AMERICAN COLLECTORS ASSOCIATION
AND CHAIRMAN OF THE BOARD,
AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

SUBMITTED TO THE HOUSE WAYS AND MEANS SUBCOMMITTEE ON OVERSIGHT,
HEARING ON THE LOBBYING AND POLITICAL ACTIVITIES
OF TAX-EXEMPT ORGANIZATIONS
March 12, 1987

Mr. Chairman and Distinguished Members of the Committee:

I am John W. Johnson, Executive Vice President of the American Collectors Association (ACA) located in Minneapolis, Minnesota. ACA is a not-for-profit trade association with more than 3,300 corporate clients who provide debt collection service for approximately 800,000 credit-granters in the United States and abroad.

I also serve as Chairman of the Board of the American Society of Association Executives based in Washington, D.C. This organization, known as ASAE, is an individual membership society representing 14,000 executives who manage nearly 7,000 trade and professional associations in the United States and abroad. ASAE was founded in 1920 with just 67 charter members. Today, the organization has an overall constituency of more than 80 million individuals and companies belonging to trade associations and professional societies worldwide.

ASAE serves three primary purposes. We seek to enhance the professionalism of our association executive members; improve the performance of the voluntary membership organizations they represent; and assist these executives and organizations in dealing effectively with public policy issues that serve the broad needs of society.

In this last regard, may I say that I have experience as a public servant in addition to my many years in the association field. I was a member of the Minneapolis City Council from 1963 to 1967, and the Minnesota House of Representatives from 1967 to 1974. I also was Minnesota's Republican candidate for Governor in 1974. Having been Chief Executive Officer of the American Collectors Association for over 30 years, as well as serving three terms on ASAE's Board of Directors, I have seen how not-for-profit trade and professional associations can play a worthwhile public policy role. Indeed, the association community has the responsibility of educating its members about the public policy process and various issues of importance. An association, by its very nature, exists to facilitate the exchange of information. Associations have flourished in this country because the principles that make them possible - freedom to meet, freedom to speak, freedom to organize - are rooted in the founding traditions of America.

ASAE members represent primarily trade associations and professional societies. The former are not-for-profit voluntary membership organizations which assist their members (either companies or individuals) with mutual business concerns. A trade association may receive tax-exempt status under Section 501(c)(6) of the Internal Revenue Code, and is permitted to engage in direct lobbying of legislators as well as "grassroots" lobbying of the general public. This type of organization can also establish a separate segregated fund to receive political contributions and make political expenditures. However, such activity cannot constitute the association's primary purpose. Other ASAE members represent professional societies. These are also not-for-profit voluntary membership organizations, through which individual members can increase their knowledge and expertise in a given field. A professional society may receive tax-exempt status under Section 501(c)(3) of the Internal Revenue Code, provided it is organized exclusively for a charitable, religious, scientific, literary or educational purpose. Furthermore, such a group cannot take part in political campaigns or devote any substantial part of its activity toward influencing legislation.

Mr. Chairman, the American Society of Association Executives welcomes the Oversight Subcommittee's review of the lobbying and political activities of tax-exempt organizations. ASAE recognizes that a comprehensive review of such activities and the tax rules applicable to them is warranted, given that some of these rules date back to 1934. It is also evident that better information is needed on the nature and extent of lobbying and political activities carried on by Section 501(c) groups. Given the increasing concern in this country over the high cost of political campaigns, the role of political action committees, etc., it is clear that tax-exempt organizations cannot and should not escape scrutiny. We agree wholeheartedly that taxpayers ought to be assured that organizations enjoying tax-exempt status are operating for the public benefit.

Mr. Chairman, I would like to make clear to the distinguished members of the Subcommittee that, if your findings indicate some tax-exempt organizations are undertaking lobbying and political activities inappropriate to their tax-exempt purpose, ASAE would fully support proper remedial measures. We believe that compliance with the law - particularly with regard to the guideposts of our Democratic system - is essential. At the same time, we believe your findings will show that the overwhelming majority of associations are operating within the law and according to their tax-exempt purpose. If any group is abusing its favored tax status, ASAE would urge the Internal Revenue Service to revoke that organization's exemption or take other measures as may be necessary to ensure compliance.

In keeping with our objective of member service, ASAE prepares and makes available studies on various aspects of association management. I would like to bring several pertinent statistics from these studies to the Committee's attention. First, ASAE's 1985-86 Association Operating Ratio Report indicates that the average association spends less than 5 percent of its budget on government relations activities. In fact, the mid-point for this expense in our survey of 450 associations was just 1 percent of total budget. Thus, lobbying activities receive relatively little emphasis in terms of most associations' expenditures. Two-thirds of associations do not even employ a full-time staff person to engage in government relations activities (Policies and Procedures of Associations, 1982). This information corresponds very closely with that collected through the IRS' Exempt Organizations/Business Master File, indicating that less than 1 percent of tax-exempt organizations appear to be engaging in lobbying and/or political activity. (Tax Administration: Information on Lobbying and Political Activities of Tax-Exempt Organizations, United States General Accounting Office, January 1987).

In this context, ASAE would like to express its concern over recent IRS proposed regulations setting limits on the permitted political activity of charitable organizations tax-exempt under Section 501(c)(3) of the Internal Revenue Code. The proposed regulations are designed to clarify the Section 501(h) election permitted public charities under the Tax Reform Act of 1976. The latter, in turn, was designed to alleviate uncertainty surrounding the historic rule that 501(c)(3) organizations devote "no substantial part" of their activity to lobbying. Beyond clearly defining how much a given organization could spend on such activity, the 1976 law defined "lobbying" as actions clearly aimed at influencing decisions on concrete legislation. This was welcomed at the time, since Congress' intent was to allow public charities to participate more confidently in the public policy process.

However, the IRS' proposed regulations appear to constrict lobbying to a much greater degree than Congress intended. ASAE, in concert with a broad-based group of tax-exempt organizations, is concerned over these proposals and their potential effect on our activities. The regulations would hamper the ability of public charities - and perhaps other associations in the future - to perform research or inform their members on public policy issues of general concern. We urge the IRS to withdraw these proposed regulations.

All available data points to the conclusion that the vast majority of tax-exempt organizations fulfill their primary educational or business function without engaging in inordinate lobbying or political activity. With regard to the latter, only 13 percent of associations report that they operate a political action committee on the federal level (Policies and Procedures of Association, 1982). In addition, ASAE's findings support the contention that association political action committees are extremely broad-based, and that contributions to these PACs come from a diverse cross-section of the American public (Survey of Association Political Action Committees, 1985). Of the 196 PACs responding to the survey, 70 percent are run by trade associations and 30 percent by other professional organizations. These groups reported raising a total of $59.1 million during 1983-84. Contributions were received from over 527,000 individuals, with an average donation of $116 per year. The average association PAC contributed $960 to a House candidate and $1,508 to a Senate candidate. An average of 64 candidates received support from the typical association PAC in 1983-84. Furthermore, only 16 percent of PAC respondents indicated that they conduct independent expenditures on behalf of candidates.

It is clear from this data that the notion of the association community having a handful of dominant PACs, funded by a small number of large contributors, is a misconception at best. Contrary to some public perceptions, the data indicate that association PACs enjoy an extremely broad base of support, donate quite reasonable amounts to federal candidates, and display definite bipartisanship. Clearly, association political action committees allow a large number of citizens (over a half-million) access to the political process. The average association PAC, in fact, receives contributions from over 3,000 individuals who believe in the efficacy of our current campaign financing system.

ASAE believes that a fundamental distinction ought to be drawn between trade associations operating political action committees through separate segregrated funds and those entities whose sole purpose is political. Most candidate-organized political action committees (COPACs) clearly belong in the latter category. These "presidential PACs" are formed primarily to supplement the potential candidate's own fundraising efforts, serving as an all-purpose expense account. In contrast, trade association PACs serve a legitimate political function within the framework of their sponsoring organization's educational or business mission. In short, associations do not exist solely to lobby. Any tax-exempt organization that does should be subject to IRS scrutiny and possible revocation of its exempt status.

The question arises as to what portion of association political activity merits IRS attention. Clearly, only a small percentage of tax-exempt organizations (perhaps 1 percent) engage in such activities at all. According to data from the IRS' Taxpayer Compliance Measurement Program, labor unions, trade associations and business leagues account for more than 90 percent of the $5.2 million expended on political activities by all the tax-exempt organizations surveyed. Thus, 501(c)(3) professional societies appear generally to be abiding by current law prohibitions against political activities (Tax Administration: Information on Lobbying and Political Activities of Tax-Exempt Organizations, United States General Accounting Office, January 1987).

According to this report, the IRS examined some 20,000 tax returns filed by tax-exempt organizations in fiscal year 1986. Lobbying or political activity was the principal issue in approximately 2 percent of the returns examined. Consequently, IRS revoked the exempt status of 25 organizations, modified the status of 24 groups, and changed the tax liability of 11 others. These 60 groups comprise just three-tenths of one percent of all the organizations examined. These findings demonstrate beyond a doubt that an exceedingly small portion of association lobbying and political activities deserves IRS scrutiny, much less remedial measures.

Finally, I would like to address two areas of political activity which have elicited much discussion over the last few years. First, independent expenditures seem to be equated in the public mind with negative political campaigning. It has been pointed out that over $23 million was spent in this fashion on presidential and congressional candidates in 1983 - 84, and that elections have become increasingly negative and rancorous. However, there is no simple one-to-one correspondence between these developments. Most independent expenditures, in ASAE's view, represent positive contributions by associations to the campaign process. The Supreme Court's celebrated 1985 ruling in the NCPAC case affirmed independent expenditures as a valid expression of freedom of speech, provided they are fully disclosed. They are, and ASAE believes that association PACs have as much right to make use of this avenue as any other legitimately-organized entity.

One other area of political activity is deserving of comment. So-called "soft money" can be contributed by political action committees to national political parties for non-federal purposes, with no disclosure required. In keeping with the spirit and intent of campaign finance reforms enacted in the last decade, ASAE suggests that such contributions be made subject to full disclosure.

To summarize, Mr. Chairman, the American Society of Association Executives firmly believes that tax-exempt organizations serve the public interest. Indeed, they have been accorded exempt status in recognition of the valuable role they play and the services they provide in our society. They are not, strictly speaking, "special interest" groups. The overwhelming majority does not exist in order to lobby, to elect a candidate, or to pursue a political agenda. On the contrary, their rather limited public policy activities remain subordinate to their tax-exempt purpose. To our knowledge, the data gathered by the Internal Revenue Service, General Accounting Office, and private organizations support this conclusion.

ASAE appreciates the Oversight Subcommittee's diligent review of the lobbying and political activities of tax-exempt organizations. We understand the concerns that have been expressed in recent years over the growth of political action committees and the influx of millions of dollars into political campaigns. However, we would urge the distinguished members of the Subcommittee to verify the legitimate role of trade associations and professional societies in the public policy process. We also urge the Internal Revenue Service to identify any abuses of an organization's tax exempt status and exercise appropriate compliance measures. Most importantly, ASAE believes that changes in current law are unwarranted, and we stand ready to assist the Oversight Subcommittee in separating fact from fallacy. We offer ASAE's resources and those of our members in helping to clarify associations' lobbying and political activities.

Mr. Chairman, I thank you and the members of your Subcommittee for the opportunity to testify on this subject on behalf of the American Society of Association Executives.

Chairman PICKLE. Mr. Jacobs, do you have questions?

Mr. JACOBS. Yes. Ms. Williams, your comment about the small organizations and the proposed regs, do I infer from that you mean that a percentage of a small organization's budget could be a far different thing than the same percentage of a large organization's in terms of fielding even one person to appear before a legislative body?

Mrs. WILLIAMS. That's exactly what I mean, Mr. Jacobs. When an organization is small, they frequently have many volunteers, and the big part of their budget would be involved with a newsletter, fundraising, that sort of thing, so that a big part of their budget would be considered lobbying.

I think that it would be very difficult for them if all of the information to their membership or to the public would be considered lobbying, rather than just that that is indeed trying to influence legislation.

Mr. JACOBS. Right. Thank you.

Chairman PICKLE. Mr. Schulze.

Mr. SCHULZE. Mr. Chairman, I have no questions for this panel, but I would like to thank them for their testimony. It was very valuable to the committee, and I thank you.

Chairman PICKLE. All right. Mr. Anthony.

Mr. ANTHONY. Thank you, Mr. Chairman.

Have any of the panelists and the groups that they represent set up a separate organization to lobby?

Mr. Dye.

Mr. DYE. Yes, indeed. Many of them do. As someone earlier said, it's a fairly typical method, and I think a perfectly appropriate one for an organization that's a 501(c)(3) organization, which is concerned about violating section 501(c)(3). It is very common for the individuals involved or for the organization itself to establish an affiliated section 501(c)(4) organization to carry out its lobbying activities.

And I think that this not only is appropriate under the statute, but serves the policy underlying the statute by ensuring that any legislative activity that's carried on by a group of affiliates is carried on with money that has not been deducted for tax purposes.

Mr. ANTHONY. In your testimony, you say that only 1 percent of the organizations, though, have opted to set up a 501(c)(4).

Mr. DYE. I don't think I said that. I have no idea what the number is.

Mr. ANTHONY. Well, then, it's in somebody's testimony. I don't know if it's someone on this panel. Maybe it's in the previous testimony.

Do you have any explanation for why there are so few people that have set up the separate affiliated organization, one that could do the research, one could do the lobbying?

Mr. DYE. Well, first, I'm not sure that that's correct, that it is such a small portion. In my experience, if a section 501(c)(3) organization has some activities which are—and you've got to understand or remember that these rules on lobbying, and particularly where we're talking about grassroots communications, they're not totally clear, and so a lot of organizations exempt from tax under section

501(c)(3) have frequent concerns about whether they're close to the line.

My experience is that most such organizations, if they're sufficiently concerned, will set up an affiliated group.

Mr. ANTHONY. I stand corrected. It is 501(h) that is used by 1 percent.

Mr. DYE. Right.

Mr. ANTHONY. Where you could elect a test involving a specific amount.

I guess what's bothering me and what I'm beginning to hear from all of the witnesses today is that they want the 501(c)(3) because the contribution is tax-deductible. They want as much of a free hand as possible, because they want to be able to use the funds for more than just the stated purpose of the research, and they want to be able to try to implement some type of policy.

And in Ms. Phillips case, I think you're the closest to walking the edge, because in your testimony you brag about the fact that you've been very successful since 1980. Yet, if I'm correct, you've also elected 501(h), so that you stay within a certain cap.

Mrs. PHILLIPS. Yes. And we do also, you know, distribute information—our direct mailings, our newsletters, and our Legislative Alert.

Mr. ANTHONY. In your case, why have you not set up the affiliated group that can do all of the hardcore lobbying that you want?

Mrs. PHILLIPS. Well, last year, out of our $9.5 million that we spent, we spent less than $51,000 for lobbying at all levels.

Mr. ANTHONY. That's amazing. I mean, the success of course, the message that you're delivering is a powerful message.

Mrs. PHILLIPS. It involves everyone, unfortunately.

Mr. ANTHONY. As I understand the controversy, it is whether somebody's tax-deductible contribution be used to finance lobbying efforts?

As I hear you, you're saying, yes, if it's not substantial, if it's done in some reasonable way, and if it is controlled and audited in some reasonable perspective.

Is that a fair summary of what you're saying?

Mrs. PHILLIPS. Well, Mothers Against Drunk Driving is the largest victim organization and the largest anti-drunk-driving organization. I think so many times people forget that almost all or a great deal of our time is spent for victims and education in our schools and other sources.

Mr. ANTHONY. Yours is probably one of the more clearcut ones. I spent 10 years in the courtroom prosecuting people who killed people driving in a reckless criminal manner, so I know the plight you've undertaken and I applaud you for your efforts. I just wish I'd had you around back when I was in the courtroom. It would have been easier to convict them.

Mrs. PHILLIPS. Well, I think a statement, you know——

Mr. ANTHONY. But you've got others that are not quite so clearcut. The American Cancer Society, for instance. They're using tax-exempt dollars to go after taxable organizations. If they are successful in their message, they actually put private enterprise out of business public financed through a tax-deductible item. I think that's where the real controversy exists and wonder how far we will allow this activity to go.

We have said we will permit it, and we will always permit it. The question is, do you think there is an increase in the political lobbying specifically for certain causes?

Do you see it in your own organizations? Do you have any fear that it's on the increase, and that your organization may be getting a bad name as a result of it?

Mrs. PHILLIPS. Our organization does not endorse any political candidate. Absolutely, we don't, and we don't allow any of our chapters to do that either.

Mr. ANTHONY. Of course, I'm asking not specifically on your organization, but in the broad context.

Do you see tax-exempt organizations doing more and more hard-core lobbying? Does it bother you?

Mrs. PHILLIPS. Well, I'm so wrapped up in just this organization, that I really—I don't see that.

Mr. ANTHONY. Mr. Johnson.

Mr. JOHNSON. Only to the extent that there are more laws that are being introduced that affect the activities of the associations or the industries. It's still a very small part of the activities of most associations in ASAE.

But it kind of comes in waves. There will be a set of laws introduced that require increased activity. Then it will die down for awhile with certain industries.

But overall, we don't perceive any broad, permanent-type increase in lobbying activities.

Mr. ANTHONY. Ms. Williams.

Mrs. WILLIAMS. Oh, I think I agree with the last speaker. In my experience in the lobbying area, I have not noticed any increase in the not-for-profit agencies.

Mr. ANTHONY. Mr. Dye?

Mr. DYE. I agree with that.

Mr. ANTHONY. You agree with that. Thank you very much. I yield back my time.

Chairman PICKLE. Mr. Johnson, I just want to clarify something with respect to your organization. You represent the bulk of the trade associations.

Now you said in your statement that it appears that the IRS proposed regulations, just issued, would constrict lobbying to a greater degree than Congress intended.

Will you explain that further? In what way would it restrict you, other than what we had intended?

Mr. JOHNSON. Well, I don't believe I commented on the proposed IRS regulations, Mr. Chairman, except in the written testimony submitted earlier, not in the oral testimony itself.

What we are—our position is that the current regulations and the current law are adequate to control the lobbying activities and the political activities of associations.

Chairman PICKLE. Well, then, in what way are the proposed regulation going to constrict your lobbying activities?

Mr. JOHNSON. I'm sorry. I can't respond to that question. But I'll ask one of my colleagues to perhaps——

Chairman **Pickle**. Well, you had made that statement, and I wondered what you meant by it.

Well, if you want to submit to us a further statement of why you think the proposed regulations would constrict your lobbying activities, I'd like to know the reason. I just don't accept it on its face, but I'm willing to listen.

Mr. **Johnson**. All right, sir. We'll be glad to supplement our testimony and submit a response to that question.

Chairman **Pickle**. All right.

[The information follows:]

asae

AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES
The ASAE Building
1575 Eye Street, NW
Washington, DC 20005
202-626-ASAE
TLX 262115

March 13, 1987

RECEIVED
MAR 1 9 1987
Ways and Means
Subcommittee on Oversight

The Honorable J. J. Pickle
Chairman, Subcommittee on Oversight
House Ways and Means Committee
1105 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

Allow me to clarify a statement included in my testimony yesterday to your Subcommittee, dealing with the IRS' proposed regulations on lobbying by certain tax-exempt public charities. The question you posed was a good one, and I should like to give the considered answer it deserves.

In my testimony, I noted that the proposed regulations are designed to implement a portion of the Tax Reform Act of 1976, specifically the 501(h) election allowing charities to be governed by clearly understood rules for lobbying and public policy work. As you know, Congress provided this as an alternative to the vague standard that 501(c)(3) organizations devote "no substantial part" of their activity to lobbying. The 1976 law set out clear guidelines on how much a given organization could spend on such activity, and defined "lobbying" as actions clearly aimed at influencing decisions on concrete legislation.

In ASAE's view, the 1976 legislation was designed to clarify and expand the role of charities in the public policy process. Congress recognized that many 501(c)(3) groups possess special expertise on key issues, without the sort of self-interest that might tinge their efforts.

In contrast, the IRS' proposed regulations have reintroduced ambiquity about what activities constitute "lobbying" by public charities. Specifically, they would define lobbying so broadly that many public policy organizations would be virtually put out of business, and traditional service groups would have to steer clear of any involvement in public policy. The proposed rules would even discourage 501(c)(3)'s from carrying out nonpartisan research or educational activities. They are clearly not what Congress intended.

The proposed regulations have already had a chilling effect, discouraging some private foundations from funding legitimate public charities. ASAE is also concerned that the rules, if enacted, could affect other 501(c) organizations that deal with social and policy questions. This is why I stated in my written testimony that "the IRS' proposed regulations appear to constrict lobbying to a much greater degree than Congress intended," and why ASAE recommends that they be withdrawn.

I hope this provides a more complete answer to your question than I was able to give earlier. I appreciate your diligence and that of your Subcommittee in exploring this entire area.

If I or ASAE can be of any further assistance as the Subcommittee develops its recommendations, please do not hesitate to let us know.

Sincerely,

John W. Johnson, CAE
Chairman of the Board

JWJ/bt

Chairman **Pickle**. Now, you say that you believe there should be a distinction drawn between trade associations operating political action committees, with separate, segregated funds, and those entities whose sole purpose is political activity.

Mr. **Johnson**. Yes, sir.

Chairman **Pickle**. You're trying to draw a distinction between a trade association PAC and an organization that is strictly set up for political purposes, and you want the two to be treated differently. Is that what you mean?

Mr. **Johnson**. Yes, sir. The PACs part of a trade association are a relatively small part of the association's overall operations. The amount of money that's raised, for example, and distributed by most associations is very small, and a small percentage of ASEA members have PACs.

This is not the primary purpose for their existence, and this is why we feel that it should be recognized as being a relatively small part of their program.

Chairman **Pickle**. Well, do all of you or any of your organizations think that we have too many of these 501(c) organizations? We've got over 25, and there may be twice that number by indirection.

Are there too many? Can we consolidate them? Do you think we should consolidate them, or do you want the present categories to be maintained?

Mr. **Johnson**. Mr. Chairman, to respond to the first part of the question——

Chairman **Pickle**. Do you have any feeling on that?

Mr. **Johnson**. No, I don't think there are too many of the 501(c) type organizations. In fact, more are being formed all the time, and that's a direct reflection of the proliferation of the kinds of businesses and professions in the American economy. There are more and more things being created all the time, and associations are an inevitable result of this.

Chairman **Pickle**. Well, most of your organizations are section 501(c)(4)'s then? Are you (c)(4)'s?

Mr. **Johnson**. No.

Chairman **Pickle**. Are you set up as (c)(3)'s or (c)(4)'s?

Mrs. **Phillips**. (3)'s.

Chairman **Pickle**. (c)(3)'s?

Mr. **Johnson**. We're a 501(c)(6).

Mrs. **Williams**. We are organized as a 501(c)(4), but it's a very small organization with a $7,000 budget. Our member agencies, most of them, are 501(c)(3). The whole idea of our coalition is for networking purposes, not for lobbying purposes per se.

Chairman **Pickle**. So you have a 501(c) (3) and a (4) both?

Mr. **Dye**. We have (3)'s and (4)'s; yes, sir.

Chairman **Pickle**. Mr. Dye, what do you have?

Mr. **Dye**. (3)'s and (4)'s; yes, sir.

Chairman **Pickle**. And what is your group?

Mr. **Dye**. The Council on Nonprofit Organizations. As I explained, it's an ad hoc coalition of section 501 (c)(3) and (c)(4) organizations, ranging from charities such as the National Center for Missing and Exploited Children; think tank type education groups, such as the Free Congress Foundation; and lobbying groups as well, including lobbying groups that are affiliated with charitable groups.

Chairman PICKLE. I raised the question earlier this morning that if you had a 501(c)(3) raising $30 million in their name, but transferring it over to a (c)(4), such activity was questionable, if not illegal.

Would you agree with that?

Mrs. PHILLIPS. Yes.

Chairman PICKLE. Those of you who had a (c)(3) and a (c)(4), are you interchanging funds?

Mrs. PHILLIPS. No, sir. MADD does not have a (c)(4).

Mr. DYE. No.

Chairman PICKLE. Do contibutions have a clear understanding to what kind of organization they're contributing?

Mrs. WILLIAMS. Yes, absolutely.

Mr. DYE. Right.

Chairman PICKLE. Well, I want to say to this panel and to those who have been with us all day that I thank you for your testimony.

We've been at this subject now, it will soon be 6 hours, and I think we've got some valuable testimony for the record. I personally am grateful that you came to testify.

Some organizations have stayed away from it, because they just don't want to say anything. They'd rather be quiet with the hope that they can continue doing whatever they're doing or for some other reason. I am hoping that we can get some of them to testify later.

This subcommittee is not trying to zero in on any one group. We have no target as such. We're trying to find out whether there is a better way to control this very fast-growing proliferation of tax-exempt organizations, and we think that there is a better way.

I've found that the testimony of the Treasury and the Internal Revenue Service was helpful to me. There is willingness to cooperate to see what we can do. None of us want to eliminate the deductibility of contributions to tax-exempt organizations, which do a lot of good for the public.

In some areas, particularly the lobbying and the political activities, there is a great deal to be improved.

The committee is going to resume again in the morning at 9 o'clock. We're going to have another long day. You are the first witnesses in this long series, and we'll be having others during the year, but we'll have another long panel in the morning.

So if there are no other questions, the subcommittee will stand adjourned until 9 o'clock in the morning.

[Whereupon, at 1:55 p.m., the subcommittee was adjourned, to reconvene at 9 a.m., Friday, March 13, 1987.]

LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

FRIDAY, MARCH 13, 1987

House of Representatives,
Committee on Ways and Means,
Subcommittee on Oversight,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:05 a.m., in room 2322, Rayburn House Office Building, Hon. Ronnie G. Flippo presiding.

Mr. **Flippo.** The subcommittee will come to order. Today the Oversight Subcommittee will continue its hearings to examine the lobbying and political activities of tax-exempt organizations.

These hearings are being conducted at the specific request of Chairman Rostenkowski. The Oversight Subcommittee has been asked to consider the extent to which tax-exempt organizations undertake lobbying and engage in political activities, whether there has been any recent growth of activity in this area, to examine the appropriateness of current law and policy in this regard, and the adequacy of IRS enforcement activities.

The scope of these hearings will include a review of the overall basic definitions of lobbying and political activities but it will not include the recently proposed 501(h) Treasury regulations.

Currently, most tax-exempt organizations are operating within the law and serving the public in a much needed educational and charitable manner.

I appreciate and thank each of you for appearing here today and taking the time to educate this subcommittee. It is important that each witness address the following issues in their testimony; one, whether tax-exempt groups should be able to use tax-deductible contributions to fund lobbying or political activities either directly or indirectly; two, your group's tax-exempt status and funding sources; three, how your individual group involves itself in lobbying or political activities; and four, your views on the effect and appropriateness of current law restrictions.

We received excellent testimony yesterday from the Department of the Treasury, the IRS, the Federal Election Commission, the GAO, the tax practitioners, and representatives of tax-exempt organizations.

In addition to summarizing your prepared testimony, the subcommittee would also benefit from your comments concerning the legislative and administrative changes proposed by those witnesses yesterday.

77-223 0 - 87 - 8

We have a long day ahead of us. We have a lot of very diverse and important testimony. So we would ask that you summarize to the extent that you can.

Let me commend each of you for coming forward and we will have our first witness, but first I would like to recognize the gentleman from Pennsylvania, Mr. Schulze, for any statement that he may have.

Mr. **Schulze**. Thank you, Mr. Chairman.

At yesterday's session, we heard from the administration and several distinguished experts. They retraced the evolution of restrictions on lobbying and political activity. Their testimony gave us a good historical perspective on how the current law developed.

The Treasury Department and the Internal Revenue Service gave us their interpretation of how these restrictions operate and how they are administered under the law.

Today, we shall hear from more tax-exempt organizations themselves. The witnesses can tell us their real world experiences of operating under the restrictions. I am eager to learn if they share the same interpretation of how the restrictions operate.

We also welcome their comments on how the law is being administered and their comments on how it might be improved.

Mr. Chairman, I believe today's testimony will compliment what we learned yesterday. It will give us the full picture and allow us to make a better evaluation of how the lobbying and political restrictions are operating. I am looking forward to hearing from today's witnesses.

Mr. **Flippo**. Thank you.

Our first witness today is a distinguished gentleman, Sheldon Cohen, former Commissioner of Internal Revenue, and a man who has served in public and private ways, has an extensive background. We are so pleased to have you here. Please proceed as you deem appropriate.

STATEMENT OF SHELDON S. COHEN, ESQ., MORGAN, LEWIS & BOCKIUS, FORMER COMMISSIONER OF INTERNAL REVENUE

Mr. **Cohen**. It is nice to be with you, Mr. Chairman.

I appear today as a witness at the request of your staff. I would like to present my own personal views. These are not the views of any client nor of my law firm. I've done this a number of times and the committee has indulged me.

I will try to go into some ideas which are complementary to those which were expressed yesterday. I had the advantage of reviewing that testimony. I will be sticking to two or three ideas that were touched on but not dealt with very deeply.

My own personal view is along the lines of Judge Learned Hand. I don't believe that I ought to subsidize somebody else's political views nor their lobbying efforts. Likewise I don't think they ought to subsidize mine. Therefore, I believe that the moderation that the code has attempted to cut out for some lobbying by exempt organizations is probably a good one. It is hard to administer and it's going to remain hard to administer. These will continue to be troublesome definitional standards, and I'll get into that in a few moments.

Let me talk about some potential abuses in the foundation area that probably are best identified by going into several examples. If these parallel ideas that you have seen outside my paper, you probably are well aware of similar types of activities.

There are three or four types of foundations tax-exempt or attempted to be tax-exempt, that I am going to try to define. One is the electioneering foundation created and controlled by Smith, a well known public figure who aspires to public office. It raises moneys from his political supporters who believe it will promote his candidacy as well as his ideology. It expands funds primarily for advertisements, mailings, and so forth, that are calculated to influence voters towards particular primaries or elections.

A different kind of foundation that is used by other people in the political world is called the helpful foundation. It is created by the supporters of Congressman Jones to promote a political agenda that is consistent with his views. The directors are friends and supporters of Jones. They have hired a number of former Jones' aides who might even work in the next Jones' campaign. They solicit money and Jones solicits money for the foundation mailings and such mailings support his political views. He appears at events around the country and the foundation pays his expenses. It does not, however, attempt to explicitly influence the outcome of any particular election.

A third kind is the good feeling. It is another generic type. It was created by the friends of Congressman Brown in his home State. Brown is active in raising the funds for it. The foundation has an independent board of directors. Brown doesn't serve. Each year the foundation causes a tree or trees to be planted in the town square of every town in the State or selected towns in the State and he may or may not appear. If he does appear, he pays his own way.

The fourth one is the good works foundation. Congressman White creates it to support the research into childhood diseases. He solicits money for the foundation through mailings, personal calls. He might even go after lobbyists and other people who ask him to help on various things. The research efforts that are sponsored by the foundation aren't sponsored particularly in White's home State. They aren't tied to election times. The foundation doesn't try to publicize White.

Now, what I'm trying to do is to give us four generic types of foundations. Of course, there are variations between all of them. For the purpose of discussion so we can look at what public officials, whether they be mayors, city councilmen, people who are running for President, people who are running for Congress or whatever office are out there doing and what the Revenue Service has to deal with.

The good works foundation is not a particularly abusive situation. I would rather it not have the name or any close association with a politician but on the other hand, there is nothing wrong with a politician doing good works. So I don't particularly find that offensive, so long as the charity isn't manipulated for particular political ends of the politician who is sponsoring it.

The good feelings foundation raises a somewhat more difficult question. It gets a little closer to the line. The effect of the tree planting will create goodwill and thus certainly some political advantage for Congressman Brown within his home State. It is thus arguably a case for regulation, at least for watching that it doesn't over reach. We will probably let them go on and plant their trees.

We could all agree, I suspect, that the electioneering foundation is absolutely verboten, I mean it's beyond the pale. I doubt there is much discussion. There have been discussions in the newspaper about organizations like this but I haven't seen much defense of them. They haven't certainly defended themselves yet.

The troublesome case is the helpful foundation. There are many of them and they cover the spectra of the political world. So I'm not throwing rocks at any particular person.

What we need to develop is some kind of a political standard or a legal standard which would allow us to draw reasonable lines among foundations in the different categories, that will be administrable. I think one of the problems we usually forget about when we enact legislation is that somebody has to go out there and administer it.

When we get into this area of partisan sensitivity, the last person to lift an exemption of one of these types of organizations is sitting before you. That was the Christian Echoes Ministries. The case wasn't finished until 1972, three years after I left office, but it was started well before I left office. Indeed, I had to warn several churches for their endorsing or damning a candidate for presidency in a particular election.

I think you struggle with this area of law. This is not easy material and you are not going to be popular no matter how you decide these issues. On the other hand, it would be very helpful to the politicians and to the American public to have some guidelines out. This is a bipartisan body—if you draft these rules, everyone is going to have to live with them.

What we have, I suspect, is a growing Gresham's law. Since political money is hard to come by, because it is non-deductible, and since charitable money is a little bit easier to raise, because it is more respectable and it is deductible, everyone tends to use 501(c)(3) organizations for their whole array of ideas. To a certain extent that promotes pluralism, and that's not all bad. But also, as Gresham's law tells us about money, tends to drive out good practice, as each organization gets closer and closer to the line, each other organization competing has to do it, too. Soon they are all standing on or over the line.

Since everyone is not a genius, some politicians are standing across the line. In usual tax practice, I always tell a client, try to figure out where the line is and then take about a half step or step back, because maybe we are not as smart as we think we are and we might have missed the line a little bit.

What we are having here is in this increasing competition in the political world, many people are standing over the line. They think they are on the safe side of the line, but they are standing over it; at least many of them are.

The standard I suggest in the paper is derived from the supporting organization test. It's already in the code. I haven't tried to define it for you because I think a good deal more work needs to be done and many more people than Sheldon Cohen with many more diverse ideas have to think about different problems with it. However, what I am saying is that if it looks like a duck and it walks like a duck and it quacks like a duck and it has webbed feet, it's probably a political organization—not a charitable foundation.

If too many of an organization's characteristics—although it calls itself an educational foundation—coincide with the political organization with which it is closely affiliated, it's probably too close to the line. That's a summary of where I have tried to go in my prepared testimony. Again, I say it needs a lot more thought and development.

We have seen numbers of newspaper stories about organizations like this and they cover candidates on the left, on the right, and in the middle. They come from acceptable parties, and from unacceptable parties, I mean they are just all over the place.

If we don't give the Service some kind of an objective standard to start using, at least some criteria which they can use, the Service will have to struggle with this on their own. This will probably get the IRS mixed up in the whole political world. That would not be good and it is after all, the responsibility of the Congress to set these standards.

In the lobbying area, and I will just touch on that for a moment. I am not going to talk about those regulations that your notice says I should not talk about, although I noticed a number of organizations did yesterday.

I am going to defend the Service's administration. The Congress is constantly doing this; 501(h) is a wonderful example of a statute that didn't need to be. Better lawyering and more thoughtful administration could have resolved that problem. The trouble is that once the Congress drafts a statute, you have to define your terms. The statute has to apply both to the good guys and the bad buys, which all the good guys always forget. The good guys will come here and say, we are good guys, and therefore, it wasn't meant to apply to us. That's nonsense. The statute was meant to apply to everybody.

The question is can we draft a statute like 501(h) where the bad guys don't abuse it. The Service has spent too much time in the mud dwelling on the bad guys, because that is where they live. The IRS live out there looking for the bad guys, because if they don't look for the bad guys, they will be before this committee explaining why they didn't catch the bad guys. That is where we are in the political foundation area. You are asking those questions.

I'm complaining here, I suppose, about the good guys, the nice foundations that would like to lobby for cleaning up the air or cleaning up parks or a zillion good things, not understanding that there are bad people out there trying to push the statute beyond where it is designed to go. The poor Commissioner of Internal Revenue, whoever he is at the moment, who happens to be a pretty nice guy and a pretty competent fellow at the moment, is trying to define the terms in ways that his Revenue agents in the field who are not experts in this area can understand. This is one of the things that I think we all forget when we sit around these rooms discussing how the statute ought to work. The statute ought to work in a way that a Revenue agent who is a well educated accountant, not a sociologist, not a political scientist, can make them work.

If we cannot define the terms so that the well educated accountant can apply them, then the Revenue Service is not in much position to apply them. The Revenue Service is populated with those kinds of people. If we want a broader enforcement which takes sociology and psychology and all of the other "ologies" into account, and I have testified before this committee and other committees on that at other times. Perhaps the administration of the tax laws in terms of tax-exempt organizations ought to be divided. We ought to have one organization that writes the rules and it would be an organization populated with people in the educational, arts, sciences, et cetera, area It would not be in the Revenue Service, but would be an independent body. We would also hope another organization which applies the rules in terms of the audits and so forth, and that would be in the Revenue Service.

That's a different discussion for a different day. It has part of this discussion because we have to write the rules in today's world with the Revenue Service applying them and expect this to be applied by reasonably intelligent good people. The Revenue Service has done a fine job, even though it is not designed to have the needed experience.

I would be glad to answer any questions you might have.

[The prepared statement of Mr. Cohen follows:]

Before Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives

Re: Lobbying and Political Campaign Activities
Tax Exempt Organizations

Statement of
Sheldon S. Cohen
Morgan, Lewis & Bockius
Washington, D.C.
March 13, 1987

Mr. Chairman and members of the Oversight Committee: I am pleased to appear before you today at the request of your staff. I have been asked to review for the committee the current issues on lobby and political activities of tax exempt organizations from my experience as a former Commissioner of IRS, Law teacher and practicing tax lawyer. I am happy to appear again before the committee in this role. My testimony represents my own personal views and is not on behalf of any client nor my law firm.

I concur in the views of several of yesterday's witnesses that there must be more appropriate remedies to forbidden activities than denial of exempt status. On occasion that penalty is too severe and on other occasions too lenient. As the Makado said "Let the punishment fit the crime." Excise taxes similar to those on private foundations may be appropriate punishment for some types of misbehavior.

In light of the testimony yesterday, I will spend most of my time on the political uses of 501(c)(3) entities. I would be pleased to talk with you about lobbying and other issues after that.

I. Areas of Potential Abuse

To focus our analysis of this matter I will first try to identify the situations in which there is a need for additional regulation. For that purpose, I would like to consider the following cases:

(a) The Electioneering Foundation was created by and is controlled by Smith, a well-known public figure who aspires to political office. It raises money from Smith's political supporters, who believe that it will promote his candidacy as well as his ideology. It expends funds primarily on advertisements and mailings which are calculated to influence voters in particular primary and then elections.

(b) The Helpful Foundation was created by supporters of Congressman Jones, to promote a public policy agenda that is consistent with his views. The directors of the foundation are friends and supporters of Jones; the foundation has hired a number of former Jones campaign aides (who are expected to work in the next Jones campaign); Jones solicits money for the foundation in mailings which promote and support his policy views; and Jones appears at events sponsored by the foundation around the country, with expenses paid by the foundation. The Helpful Foundation does not, however, attempt explicitly to influence the outcome of particular elections.

(c) The Good Feeling Foundation was created by friends of Congressman Brown in his home state. Brown is active in raising money, but the foundation has an independent board of directors. Each year the foundation causes a tree to be planted in the town square of every town in the state. Brown may or may not appear at some of the planting ceremonies. If he is able to attend the foundation does not pay his expenses.

(d) The Good Works Foundation was organized by Congressman White to support research on childhood diseases. White solicits money for the foundation, through mailings and personal calls. Some of these requests for contributions may be made to individuals or companies which have official dealings with White's Congressional committees. The research efforts sponsored by the foundation are not focused in White's home state, or timed to elections, and the foundation does not publicize its connection to White except in connection with fundraising.

II. Identifying Abuse Cases

I suggest, for purposes of this discussion, that although we may be a bit hesitant at seeing public officials use their position to persuade persons interested in the legislative process to contribute to particular charities, the Good Works Foundation is not an instance of tax abuse. Public figures should not be denied the right to support private charities, so long as the charities are not manipulated for political purposes.

The Good Feelings Foundation raises a somewhat more difficult question, since the effect of its tree planting program may be to create good will and thus some political advantage for Congressman Brown within his home state. This is arguably a case for regulation, but I believe that we should be wary about disrupting tradition without good cause, and my inclination would be to let the trees grow in peace.

I suspect that we can all agree that the Electioneering Foundation represents an abuse of exempt status - one which probably could be addressed under present law. The very troublesome case is the Helpful Foundation. Here we have clear indications that an exempt organization is furthering private political interests. However, it is not doing so in such an explicit way that the Revenue Service under current law has been able to respond effectively.

What we need, I believe, is a legal standard that will allow us to draw reasonable lines among foundations in these different categories, and that will be administrable. Particularly in an area with partisan sensitivities, I do not believe that the test can be simply one of purpose or intent. The problem with this kind of subjective standard is evident when you try to apply it to the Helpful Foundation. Is it the purpose of the foundation (as distinct from the hopes of particular contributors or directors) to further the candidacy or political career of Congressman Jones? Or is it the purpose of the foundation to educate the public about issues on which Jones happens to have taken particular positions? I think that the only standard that is likely to be reliable in determining the exempt status of the Helpful Foundation is one that has some reference to objective realities, while still leaving room for the exercise of administrative discretion.

III. Formulation of Standard

There is in the law now what I think could be a very useful model for a regulatory standard. In determining whether an organization qualifies as a "supporting organization" under section 509(a)(3) - meaning that it is exempt from the private foundation rules by virtue of its relationship to an established public charity - the law looks to the degree of control exercised by the public charity over the supporting organization, and to the "responsiveness" of the supporting organization to the established charity. The relationship between the two entities is evaluated by reference to a series of objective criteria. I believe that, using and adapting this model, a fair and administrable test can be fashioned for identifying the abuse cases in the political foundation area.

Treasury regulations under section 509 require that a supporting organization be either operated or controlled by, or controlled in connection with, or operated in connection with, the established charity. Overall, the regulations are designed to ensure that the established charity exercises a substantial degree of direction over the policies, programs, and activities of the supporting organization; that the supporting organization will be responsive to the needs or demands of the established charity; and that the supporting organization will constitute an integral part of or maintain a significant involvement in the charity's operations.

Obviously I'm not proposing that we simply transport the 509(a)(3) regulations, which are complex and specific, over into section 501(c)(3). I suggest, however, that the standard for determining whether a supporting relationship exists provides a very useful model for what could be a more workable test of political involvement. Substitute for the established public charity in the supporting organization standard the political figure or the political group or cause - it doesn't have to be an individual. Now apply tests such as those set out in the section 509(a)(3) regulations. Does this politician or political group, along with aides, supporters and others who for this purpose could be considered related persons, control the foundation? Is there a close and continuous working relationship between directors or employees of the foundation and associates of the political figure or members of the political group? Does the foundation carry on activities (such as research, publications, mailings or advertisements) which might otherwise be carried on directly by the political figure or group? Does the foundation incur expenses (such as travel costs of a candidate) which might otherwise be paid by the political figure or group?

I believe that, from the existing guidelines on supporting organizations, a standard for political involvement can be fashioned that will combine some objective benchmarks with some administrative discretion; that will be familiar to the IRS; and that will provide to exempt organizations and their sponsors some predictability and a basis for reasonable planning.

Here, as in the lobbying area, we are dealing in a public policy area where Gresham's law applies. That law states that "bad money drives out the good." In the area of political activity and lobbying by 501(c)(3) organizations, I'm afraid that bad practice is driving out the good. We must find ways of making the IRS effective in policing the activities of those organizations which attempt to operate at the outer limits of what is acceptable. In order to do this the Congress must assist the Commissioner with more clearly articulated rules and definitions. Section 501(h) is symptomatic of this lack of definition. The Congress in 1976 enacted a statute attempting to liberalize some lobbying activity. Congress did not define its terms, hence the IRS was required to define the statutory terms. Now the Service has done so and you have heard many organizations complain that the IRS does not understand. If that is so, and I do not know that it is, the Congress must say what it wants. Do not delegate the definition to the Commissioner and then complain when he does his job. Tell him precisely what you want. I suspect some of those who will complain to the Commissioner about those definitions will have more trouble in writing their own definitions - which do not open the flood gates to any type of lobbying. I, for one, agree with Judge Hand. The public should not subsidize, through tax deduction, political or lobbying activities except in very narrow circumstances. Otherwise very smart tax lawyers will design entities which can support anything and everything. I do not believe that the Congress or the American people want such a rule.

Mr. **Flippo**. Thank you very much. Have you had a chance to review the Treasury recommendations?

Mr. **Cohen**. Somewhat. I got them about 5 last night and I finished this about 6:30.

Mr. **Flippo**. In your brief examination of them, do you feel they go far enough? What would be your comments about them?

Mr. **Cohen**. Well, I'd rather do that after I've had a little time to contemplate. What I see is the Service being fairly open, more, open than usual. That's Larry Gibbs' personality. He is willing to admit that the IRS could use a little beefing up here. I find that to be good. I find certain defensiveness, of course. You can't get the spitballs all thrown at you without being a little defensive.

Mr. **Flippo**. Do you think that we really know what's going on out there?

Mr. **Cohen**. No, sir; you don't. The Service doesn't either.

Mr. **Flippo**. Further action would be necessary to ascertain that?

Mr. **Cohen**. I think that's right. You had the GAO report yesterday which was helpful. You had some outsiders who gave you some pretty good background. But statistically and analytically, the Service doesn't know how many of these kinds of organizations there are. One could do a survey. They know the 3,300 that have elected 501(h), but of that 3,300, they have no breakdown of degree of activity within them and of the hundreds of thousands of the other 501(c)(3)'s and great numbers of other exempt organizations which have different rules. However, you only look at the (c)(3)'s. There are a spectrum of people doing absolutely nothing in the area that you would worry about and people doing a great deal. Again, the IRS does not have breakdown of information there.

If you were going to try to do a very careful job, as the committee usually does, you need a lot more data.

Mr. **Flippo**. Thank you. Mr. Schulze.

Mr. **Schulze**. Thank you. Along that line, Mr. Cohen, do you think we could devise or you could devise a form 990 which would secure the data that we would need to make intelligent decisions?

Mr. **Cohen**. Yes, sir. I'm sure if you put a committee of people both inside the Revenue Service and outside who dealt with these kinds of organizations extensively, one could design special reports. I don't know that you want that kind of information all the time but at least you could start off with some special reports that were required of either all or a subsample of the organizations.

If you want to get this information rapidly, let's say within the next 2 or 3 years, you would have to design a subsample and get it out to the kinds of organizations that would get you back information, then you could get it statistically blown up.

Mr. **Schulze**. I agree with you. I think that really should be our first step, to change the form 990 so that we can derive information which would be valuable to us.

You said everyone tends to use 501(c)(3)'s because of tax deductibility. Were you just being expansive?

Mr. **Cohen**. No.

Mr. **Schulze**. I don't really see that. I would like you to expound on that a little bit. I see an awful lot of organizations out there other than (c)(3)'s and I realize as you do the benefit of a (c)(3) versus the others, both tax deductible and nontaxable. There are an awful lot of other organizations as well.

Mr. COHEN. I would be the first to agree with you, Mr. Schulze, that we probably—the Congress certainly and the rest of us also have spent too little time looking at the other 24 subdivisions of 501. There are subdivisions there that were drafted in 1909 and have remained unchanged since the corporation excise tax in 1909.

I would agree with you. I find that the social welfare or many of the other kinds of organizations are less obtrusive, if you will, or less bothersome in this area, simply because many of them carry no tax deductibility. That is if Sheldon Cohen wants to lobby for——

Mr. SCHULZE. You mean other then (c)(3)?

Mr. COHEN. Sure. That's right. Now, I should say labor organizations and business leagues do have certain deductibility and that aspect of it would have to be looked at, too. If Sheldon Cohen wants to lobby that we should not cut down trees of greater than three inches, just to pick some topic that he might be interested in, he can spend all his money if he wants to and do that and it might be a worthy cause but he gets no deduction.

If Sheldon Cohen creates the preserve the trees organization and he makes his tax deductible contributions, it creates two things. It creates a tax deduction that my fellow citizens are subsidizing, my particular view. It also gives an aura of respectability to the cause. Somehow or other, our society accepts things that are tax deductible in a different way than if they are a business league or just an ordinary interest of mine.

Mr. SCHULZE. But they are in a different league.

Mr. COHEN. Sure.

Mr. SCHULZE. You also said IRS spends too much time looking for bad guys.

Mr. COHEN. That's its business.

Mr. SCHULZE. But in this area, there have not been an awful lot of bad guys. There are some but not——

Mr. COHEN. No, percentagewise, that's right. It's like apples, a bad apple in the barrel smells and spoils the batch.

Mr. SCHULZE. You are right. I think we have to be careful about condemning charitable organizations with a broad brush when any in-depth investigation has shown that it is a minuscule number who are either crossing the line or abusing it.

Mr. COHEN. I think that's right. One of the wonderful things about having an investigation of exempt organizations, which I've been through now for 35 years periodically you can have an investigation of exempt organizations and you could beat the Revenue Service over the head easily because this is number one, as you say, an area where there is not too much abuse, there is some. Of course, the abuse becomes very noteworthy because most organizations behave correctly. If they all behaved badly, it wouldn't be news worthy when one went off the reservation.

Mr. SCHULZE. As a tax practitioner, do you have people coming to you who actively seek ways of hiding lobbying activities or set up organizations that you might feel in your heart might be a deliberate attempt to use a 501(c)(3)?

Mr. COHEN. Well, to be diplomatic, I will say it has happened in the past.

Mr. SCHULZE. In your opinion, is this widespread?

Mr. COHEN. Yes, sir. Well, I had an excellent view of it many, many years ago, a great many years ago. I was general counsel of one of the major political parties for a number of years and was very close and friendly with the general counsel of the opposite political body—I was general counsel of the democratic party and the deputy general counsel of the republican party was a close personal friend of mine for years, my parents had known his parents. We were close personal friends. We used to exchange ideas.

When we were being square with each other, acknowledge that some of our supporters and friends in the political world were pushing some of these ideas well beyond what the two of us would do if we were able to hold people in line.

Mr. SCHULZE. Would you routinely advise a (c)(3) to set up a (c)(4) to be their lobbying arm?

Mr. COHEN. I've done that before; yes. I think the better practitioners would say, look, when you are going to get too close, let's divide it, let's make sure that we have good accounting and let's make this defensible because that's best for both of the organizations. It is better not to have it all deductible and have it defensible than to try to get it all deductible and then find out you have screwed up the works.

Mr. SCHULZE. Thank you.

Mr. FLIPPO. Thank you. Mr. Thomas.

Mr. THOMAS. Very briefly because I find myself running into the same problems in these areas that I do in part with political parties when we talk about going into public financing. What you try to do is put reality in a bottle and you can never get it all in there. People are very clever at creating ways to get out.

Is the appropriate way just pure disclosure? Will that really solve the problem?

Mr. COHEN. Well, I don't——

Mr. THOMAS. Is it appropriate for IRS to function in that manner?

Mr. COHEN. If you are talking about lobbying, I philosophically don't think disclosure is the answer. That is because I just don't think that a tax-exempt organization which is operating partially with my money, ought to be able to lobby for those things that I find anathema. On the other hand, an educational organization can. I mean, that's the distinction we make. That is that if a university wants to teach Adam Smith, it has the right to teach Adam Smith. It can't say that John Maynard Keynes never existed and he didn't have some pretty good ideas or vice versa.

They can't go out and lobby for a single idea or a group or clash of ideas that would push the political system. They have to let the ideas catch on and the rest of us folks can go out and push whatever ideas we want. Those are the differences between a lobbying organization on the one hand and an educational organization on the other.

Mr. THOMAS. Which we can all state with extreme examples with relative ease——

Mr. COHEN. Right.

Mr. **Thomas** [continuing]. All of a sudden when you get out in the real world, you wind up with a distinction without a difference.

Mr. **Cohen**. And the poor revenue agents out there trying to enforce it.

Mr. **Thomas**. All right. Is the IRS the proper vehicle?

Mr. **Cohen**. No. I've said that many times, but there isn't any better one, unfortunately. The IRS has been apolitical. The wonderful thing about the Revenue Service is it had its scandal early, 35 years ago, a year before I came to the Revenue Service, there was a terrible scandal. Before that, all of the key operating officials of the Revenue Service were politically appointed and responsible to the political world. After that, a single person, the Commissioner, was the only person politically appointed and the Commissioner, whoever he has been since that time, in the last 35 years, always kept a copy of the King & Keane hearings, at least all the ones I've known have kept a copy of the King & Keane hearings close on their desks and if anyone says something silly, you can say, "read this."

I think politicians of both parties, Presidents and others of both parties have been wise enough to understand that you appoint a person on the basis of his competency and not whether he is a loyal supporter of X, Y or Z. The organizational structure is such that the Commissioner of Internal Revenue just doesn't get into the flow of cases. He stays back out of it. Yes, they get in a lot of trouble because this is a troublesome area and there are many mines which you can trip off on on any given day but they call them as they see them.

The IRS won't call very many in this area, simply because we are dealing with an under staffed, under manned, under funded organization, with this huge workload. The major function of the IRS is to bring in revenue and an exempt function is specifically designed not to bring in revenue. Therefore, no matter how you enforce it, you are not going to get enough money out of it to spit at, to put it crudely.

Mr. **Thomas**. If we are coming to a Y in the road which I think either leads us in the direction of a Federal lobbying commission or swift and sure punishment as the sure deterrent for those folks who are not following a fairly narrowly and precisely written law, which fork would you propose that we take?

Mr. **Cohen**. No. 1, I don't believe we are at that point. No. 2, I don't think it is as dire as that. Many of the organizations are going to appear before you. They elected (h) because they wanted to be sure, not because they were in trouble before. I have never elected (h). I have been practicing law a long time. I just never elected (h) because I could see that (h) was just a license to complicate my life and my organization's life. The accounting rules have to be tougher.

As soon as the Commissioner ever got time to put out some rules, they had to be tougher because you asked the Service to quantify things. Once you have to quantify things—sure, the term "substantial" is nebulous, but as soon as you quantify it, it's worse. They found out. Okay, you paid your money and you made your choice and the bed is a little prickly.

That is not to say that the Commissioner's rules are perfect. They're not. There are many rules within that system that I might complain about, that is what the hearing is for. If one were to read those rules with the sense that there are terrible people out there doing terrible things, and the Service has to stop them, and I think that is what the reg writer was doing. He dwelled too much with the dark and not with the light. There is going to be a balance. I suspect those regs will be balanced out. Either they will balance out or the Congress is going to modify the statute, one or the other. I suspect the former, not the latter.

I don't think we have gotten to that point where this is Chicken Little, the sky is not falling in. I have been telling charities this is not the end of the world. The Commissioner is not your enemy, go tell him what your problems are and then if he doesn't do it, then you have an enemy.

You see, the problem is they all began these little in groups and each one says, what if this, what if that, and they just began to feel worse and worse and worse. As I say, I think the charities have just overdone it.

Mr. **Thomas**. The problem from our perspective is that somehow information travels so much faster today that the problem has multiplied geometrically, the loop holes are discovered much more rapidly.

Mr. **Cohen**. We are training these young tax lawyers better and they are smarter than we were.

Mr. **Thomas**. Yes. Mr. Cohen, I would appreciate also if you would react to the suggestions that were made yesterday.

Mr. **Cohen**. I'd be glad to do that with the staff.

Mr. **Thomas**. In writing; I would appreciate it.

It would be unfair to the Commissioner and the Assistant Secretary to give you an off the cuff—I got these very late last evening. We would like it in writing. Thank you.

Mr. **Cohen**. Yes, sir.

[The information follows:]

Morgan, Lewis & Bockius,
Washington, DC, March 13, 1987.

Hon. J.J. Pickle,
Chairman, Subcommittee on Oversight, Committee on Ways and Means, House of Representatives, Cannon House Office Building, Washington, DC.

Dear Jake: I was asked by the Committee to give my views on the Treasury legislative suggestions made by Roger Mentz during his testimony on March 12. Since I had not had time to review the suggestions fully, it was agreed that I would send my views in writing.

I generally agree with Mr. Mentz' suggested legislative ideas. My reaction to his proposals is as follows:

MENTZ TESTIMONY

P. 9: He does not recommend change in the restrictions on lobbying. As I testified, I agree. The *Slee* rule is a good one.

P. 10: He suggests that the prohibition on political activities is sound. I agree. We do not allow deductible political contributions. If 501(c)(3) organizations may assist in anyway in such activity, it will be very destructive of the present system. Everyone in such a case will begin to form such organizations and the resultant scandal will cause a terrible reaction against exempt organizations.

P. 10: In the fifth paragraph on this page, Mr. Mentz agrees with my proposal that we must police carefully any political activity whether by research, position paper or otherwise by a (c)(3) affiliated with a candidate for public office.

P. 11: Second paragraph. Disclosure of names and other appropriate information about affiliates is a good idea. This definition will be difficult, but should include even major political supporters of candidate—see my testimony.

P. 12: I agree with the excise tax suggestions. In the political activity, I would be very severe. A small tax or penalty will only encourage more activity. The excise should be tough enough to receive notice and, if correction is not made even more severe, sanctions may be necessary.

P. 13: Successor organization problem. I agree.

P. 13: The idea of a monetary penalty on the organization and/or managers is a good one. The warning should only be applied to an error arising innocently. Otherwise, people with blatant trangressions will be given another chance.

Should you or your staff desire to go into any of these matters in more detail or discuss possible legislation, I would be pleased to work with you.

Again, I thank you and your staff for your courtesy.

Best regards.

Sincerely,

SHELDON S. COHEN.

Mr. FLIPPO. Thank you very much. We sincerely appreciate your testimony and your being with us today and giving us the benefit of your views. Thank you.

Mr. COHEN. Thank you, Mr. Chairman.

Mr. FLIPPO. Our next panel of witnesses is John Buchanan, chairman of the People for the American Way, a distinguished former member of this body, from Alabama, I might add, and Edwin Feulner, the president of the Heritage Foundation.

Gentlemen, we are pleased that you are joining us today. As you can see, we have a rather lengthy list of witnesses today. We look forward to your testimony and hope that you will summarize as you deem appropriate. It is a pleasure to have you. Please proceed as you see fit. You might introduce those at the table with you, if you care to.

STATEMENT OF JOHN BUCHANAN, CHAIRMAN, PEOPLE FOR THE AMERICAN WAY, ACCOMPANIED BY MICHAEL HUDSON, GENERAL COUNSEL

Mr. BUCHANAN. Thank you very much, Mr. Chairman and members of the subcommittee.

I am John Buchanan, chairman of People for the American Way, a nonpartisan, public-interest organization dedicated to the protection and preservation of constitutional liberties in the United States.

We have submitted a written statement for the record, Mr. Chairman. We will summarize it, if it may appear in the record in its written form.

Mr. FLIPPO. Without objection.

Mr. BUCHANAN. On behalf of our organization of 250,000 members across the country, I am pleased to appear before you today. Seven years ago, People for the American Way was founded by a distinguished bipartisan group of religious, civic, and educational leaders committed to our Nation's heritage, which is founded on the principle of freedom and respectful of diversity and pluralism.

The organization's mission was to educate the public on the vital importance of this tradition. As we approach the bicentennial of the Constitution, Mr. Chairman, it seems to me the American people need to be reminded of this, which is a priceless heritage and one of the great political achievements of human history, and it's celebration is what we're all about.

We also exist to defend against a new breed of intolerance that attacks and suppresses public education and the Constitution itself.

Since its inception, People for the American Way has emerged as a unique source of informed commentary and investigative research and is a steadfast defender of first amendment freedoms and constitutional liberties.

As in the case of other nonprofit organizations established for the specific purpose of public education, People for the American Way is a tax-exempt 501(c)(3) organization. Concomitantly, People for the American Way understands, as all charitable organizations should, that 501(c)(3) organizations are not permitted to engage in political activities. We are in complete compliance with that rule and in complete agreement with its purpose.

Participation in public policy formation through lobbying activities, however, is allowable and is encouraged by the law. In 1984, in recognition that we wanted to expand our public policy activity and ensure that we would not jeopardize our 501(c)(3) status, People for the American Way established an affiliated 501(c)(4) organization. The 501(c)(4) is a separately incorporated entity with its own bylaws and board of directors.

Allow me to emphasize to the chairman and the members of the subcommittee that People For's 501(c)(4) lobbying activities do not make use of a single tax-deductible dollar, that People for the American Way utilizes its 501(c)(4) solely for the purpose of participating in public policy formation. We do not engage in political activities, nor do we maintain a political action committee.

Open and informed debate on the issues is what distinguishes the American system of government from less democratic ones. Having grappled with the complex issues confronting our Nation while in Congress for 16 years, I can attest to the value of a broad range of information and views in writing legislation. As a Member of the Congress, I wholeheartedly supported bipartisan efforts to clarify the lobbying laws and reinforce the need for charities to be part of the legislative process, involved not just in the deliver of services, but in the development of policies governing those services.

The Tax Reform Act of 1976 creating election provisions under section 501(h) is one excellent example.

The nonprofit sector of society makes a unique contribution in the information it provides to the Congress and to State and local legislators. One must only consider the vacuum that would exist if lawmakers were informed only by the private sector and by government itself. Furthermore, as a nation, we are experiencing one of the worst periods of voter apathy. In this year of the bicentennial of the Constitution, we need to reaffirm our support for an informed citizenry and the promotion of public participation in the policymaking process.

Mr. Chairman, I would like to make clear, as People For chairman, that we want everybody to contribute to this process. We feel you, as the Members of the Congress, need to hear a wide range of points of view.

Seated to my left is the distinguished president——

Mr. FEULNER. To your right.

Mr. **Buchanan**. To my right. [Laughter.]

Always to my right is the distinguished president of the Heritage Foundation, an organization characterized by scholarly error. [Laughter.]

Which is usually brilliantly and intelligently wrong. [Laughter.]

But we want you to hear from Ed Feulner. We think it helps you in your deliberations, and other people all across the spectrum.

In the context of People for the American Way, I would like to share with you several examples of our work, specifically efforts to oppose textbook censorship and a tax on separation of church and state.

Last week, a Federal judge banned 45 history, social studies, and home economics textbooks from the Alabama public schools. The objections raised in the courtroom are part of an ongoing assault on public schools, which denounces the diversity of viewpoints and the teaching of reasoning and thinking skills.

I feel that the results of such court decisions will produce students trained like robots instead of students who are taught how to build them.

The same subject of secular humanism addressed by the Federal judge in Mobile found its way into Federal legislation in 1984. An amendment to the 1984 Education for Economic Security Act prohibited the use of magnet school funds for, "any course the substance of which is secular humanism."

People for the American Way was able to inform the Congress of the dangers of such language because of our experience in the area of censorship all across the United States, particularly the use of secular humanism by proponents of censorship to oppose whatever they disapprove of in public schools and libraries.

Congress realized the provision was potentially injurious to public education and voted to remove the language. We believe the Congress acted responsibly in the interests of public education, but this only occurred because of the ability of nonprofit organizations to share information and to engage in public policy formation.

During the 99th Congress, legislation was considered to provide for silent prayer in public schools. In an effort to enable Congress and its staff to evaluate the legislation, we sponsored a briefing given by religious leaders and constitutional scholars.

People For has also been acting on a number of constitutional public policy issues in State legislatures. You are aware, Mr. Chairman, of our leading role—or Chairman Pickle is aware, I'm sure, of our leading role in Texas in convincing the Texas Legislature to reform the text book selection process, an effort made by a coalition we helped to form and led by our general counsel, Mike Hudson.

In my view, these examples and activities demonstrate the invaluable role that nonprofit organizations play in public education and public policy development.

Chairman Flippo and distinguished members of the Oversight Subcommittee, our Nation is in the midst of an information age when policies about information become decisions about the nature of society itself. Laws and regulations which limit the free flow of information between nonprofit organizations and lawmakers carry a dangerous and fundamentally undemocratic presumption—that public participation is unnecessary, because Government knows what is best for the people.

I feel that restricting the flow of ideas and information from public charities will produce a Government isolated from the governed. I urge you, in your wisdom, to ensure that we maintain an informed and responsive government to address our Nation's needs.

Thank you.

Mr. FLIPPO. Thank you, Mr. Buchanan. I think we would like to hear both witnesses' testimony before we go to questions, so if you would proceed.

[The prepared statement of Mr. John Buchanan follows:]

Statement by John Buchanan, Chairman, People For The American Way

Chairman Pickle, and distinguished members of the Ways and Means Subcommittee on Oversight. I am John Buchanan, Chairman of People For The American Way, a nonpartisan public interest organization dedicated to the protection and preservation of constitutional liberties in the United States. On behalf of our organization and its 250,000 members across the country, I am pleased to appear before you today.

Seven years ago, People For The American Way was founded by a distinguished bipartisan group of religious, civic and education leaders committed to our nation's heritage which is founded on the principle of freedom, and respectful of diversity and pluralism. The organization's mission was to educate the public on the vital importance of this tradition, and to defend against a new breed of intolerance that attacks the press, public education and the Constitution itself.

Since its inception, People For The American Way has emerged as a unique source of informed commentary and investigative research, and as a steadfast defender of First Amendment freedoms and constitutional liberties. Best known for exposing and countering the Religious Right's attempt to tear down the wall separating church and state, People For The American Way plays a leading role in defending and promoting religious freedom, the freedom to learn, public education, equal justice, an independent judiciary, and free and open debate.

As in the case of other nonprofit organizations established for the specific purpose of public education, People For The American Way is a tax-exempt, 501(c)(3) organization. Concomitantly, People For The American Way, understands, as all charitable organizations should, that 501(c)(3) organizations are not permitted to engage in political activities. We are in complete compliance with that rule and complete agreement with its purpose.

Participation in public policy formation through lobbying activities, however, is allowable and I believe encouraged by law. In 1984, in recognition that we wanted to expand our public policy activity and ensure that we would not jeopardize our 501(c)(3) status, People For The American Way established an affiliated 501(c)(4) organization. The 501(c)(4) is a separately incorporated entity, with its own bylaws and board of directors. Allow me to emphasize to the Chairman and to the members of the Subcommittee that our organization's 501(c)(4) lobbying activities do not make use of a single tax-deductible dollar.

Open and informed debate on the issues is what distinguishes the American system of government from less democratic ones. Having grappled with the complex issues confronting our nation while in Congress for sixteen years, I can attest to the value of a broad range of information and opinions in the legislative process.

As a Congressman I heartily supported bipartisan efforts to clarify the lobbying laws and reinforce the need for charities to be part of the legislative process, involved not just in the delivery of services, but in the development of policies governing those services. The nonprofit sector of society makes a unique contribution in the information it provides to Congress, and state and local legislators. One must only consider the vacuum that would exist if lawmakers were informed only by the private sector and the government itself. Today, I am convinced more than ever before that the nonprofit sector not only prevents human needs from going unmet, but prevents many of our nation's needs from going unaddressed. Furthermore, as a nation, we are experiencing one of the worst periods of citizen apathy. In this year of the Bicentennial of the Constitution, we need to reaffirm our support for an informed citizenry and the promotion of public participation.

In the context of People For The American Way, I would like to share with you several examples of our work, specifically efforts to oppose textbook censorship, attacks on separation of church and state, and to expose abuses in the award of federal grants. These examples underscore the crucial role of the nonprofit sector in shaping public policy formation.

Censorship

Last week, in a decision in a federal court in Mobile, Alabama, Judge Brevard Hand banned 45 history, social studies, and home economics textbooks from the public schools -- in the middle of the school year. The objections raised in the courtroom are part of an ongoing assault on public schools which denounces a diversity of viewpoints and the teaching of reasoning and thinking skills. The Rev. Pat Robertson, who funded the lawsuit against the Alabama schools, invokes "secular humanism" to voice these objections and any others when he sees something he dislikes in our nation's public schools.

The same subject of "secular humanism" addressed by the federal judge in Mobile found its way into federal legislation in 1984. An amendment to the 1984 Education for Economic Security Act prohibited the use of magnet school funds for **"any course the substance of which is secular humanism."** People For The American Way was able to inform Congress of the dangers of such language because of our experience in the area of censorship, particularly the use of "secular humanism" by proponents of censorship to oppose whatever they disapprove of in public schools and libraries. Congress realized that the provision was potentially injurious to public education and voted to remove the language. We believe People For The American Way provided useful information that enabled Congress to act responsibly in the interests of public education. This information would not have been brought to the attention of the Congress without the ability of nonprofit organizations to engage in public policy development.

Abuses in Federal Grants and Resources

During the 99th Congress, People For The American Way exposed questionable Department of Justice and Legal Services Corporation grants. People For shared its research findings with congressional oversight committees to reveal that grants of more than one-half million dollars -- some made during spending freezes -- were an abuse of taxpayers funds, and in some cases, undermined basic constitutional guarantees.

In one example, the Department of Justice made a $45,000 grant for a conference on black families that promoted the Rev. Pat Robertson as a co-sponsor, to the exclusion of any other religious group, and specifically authorized the use of taxpayers funds to underwrite the prayer meeting at the conference.

Another example involved a grant for $186,710 made during a spending freeze at the Department of Justice Juvenile Justice Program. Two grantees proposed to write a textbook on the Constitution. One of the grantees was a professor at Jerry Falwell's Liberty University, and the grant application described a book very similar in content to one which he described in monograph as needed by the sectarian Christian school community. Both grantees had expressed the view in other writings that the Bill of Rights does not apply to the states.

In another case, $337,000 granted by the Legal Services Corporation was specifically earmarked to provide technical assistance, training publications on constitutional law, and legal assistance to the Constitutional Law Center run by James McClellan programs. Findings provided by People For The American Way to House and Senate Judiciary Committees revealed that the grantee had failed to use the funds to meet the terms of its contract. [Among the requirements not met included: preparation of a litigation manual; publication of sources materials for legal research; a scheduled conference; and meeting the needs of the LSC field programs.] The Legal Services Corporation was prompted to conduct its own audit and review, and withheld final payment because of incomplete work by the grantee. LSC did not renew the grant.

In all of these examples, the which facts were brought to the attention of Congress prompted inquires and action.

Church and State Separation

People For The American Way has responded to instances of abuse of the separation of church and state by federal officials. In March, 1984, People For The American Way learned that the head of the Department of Education's regional office in Denver mailed a sermon to private schools in his region which urged establishment of a "Christian nation" and raised the need for "a truly Christian educational system for our young people." The letters were mailed at government expense with a cover memo on official Department of Education stationary decrying "government intervention into ... areas of parental responsibility." The sermon was written by the then director of the Regional Liaison Office of the Department of Education whose previous job was as the executive director of Jerry Falwell's Moral Majority.

A private citizen, and People For The American Way member, subsequently wrote to the Department of Education regional head in Denver expressing his opposition to the mailing. He received a response in the form of an abusive letter from a U.S. Treasury employee who called the citizen a "pathetic creature" and warned: "When you die, you will be giving account to Jesus Christ, your creator, who also happens to be a Christian. I hope you are prepared."

Congressional committees were provided with the results of People For's findings and one subcommittee was instrumental in getting the Inspector General of the Department of Education to conduct an investigation into this matter.

During the 99th Congress, legislation was considered to provide for silent prayer in public schools. In an effort to enable Congress and its staff to evaluate the legislation, People For The American Way sponsored a briefing given by religious leaders and constitutional scholars. People For The American Way has also been active on a number of constitutional public policy issues in state legislatures. You are aware, Mr. Chairman, of our leading role in Texas in convincing the Texas legislature to reform the textbook selection process.

In my view, these examples and activities demonstrate the invaluable role nonprofit organizations play in public education and public policy development.

Conclusion

Chairman Pickle, and distinguished members of the Oversight Subcommittee, our nation is in the midst of an information age when policies about information become decisions about the nature of society itself. Laws and regulations which limit the free flow of information between nonprofit organizations and lawmakers carry a dangerous and fundamentally undemocratic presumption: That public participation is unnecessary because government knows what is best for the people. I fear that restricting the flow of ideas and information from public charities will produce a government isolated from the governed. I urge you in your wisdom to ensure that we maintain an informed and responsive government to address our nation's needs. Thank you.

STATEMENT OF EDWIN J. FEULNER, JR., PH.D., PRESIDENT, THE HERITAGE FOUNDATION

Mr. **Feulner**. Thank you, Mr. Chairman. It's my honor to appear before this distinguished subcommittee. I ask that my full statement be read into the record, and I will summarize as best I can.

Mr. **Flippo**. It will be included.

Mr. **Feulner**. The Heritage Foundation, Mr. Chairman, is a tax-exempt, nonpartisan public policy research organization or think tank, and with more than 100,000 supporters, we are the most broadly supported, general public policy research organization in the United States today. As a research institution, we do not engage in propaganda or otherwise attempt to influence legislation or engage in political campaign activities.

We deal in the marketplace of conservative ideas and American ideals. We have no substantial role in what others do to translate our work into concrete legislative proposals, nor do we seek to advance or inhibit pending or proposed legislation.

Our publications are truly educational. They meet the full and fair presentation of the facts test, as required under the Internal Revenue Service regulations, and they have been found, after an exhaustive IRS audit, to be in compliance with the Internal Revenue Code.

Saying that, Mr. Chairman, is not necessarily to say that we always know that we are in complete compliance with existing law. As the members of this committee know, section 501(c)(3) of the Internal Revenue Code provides that, "no substantial part," of our resources can be devoted to lobbying activity.

We don't know, nor does the Congress, nor does the public, what secret rules the Internal Revenue Service uses to determine what is "substantial." Many 501(c)(3) organizations operate on the assumption that there is a safe harbor expenditure test of 5 percent of the budget; however, the Internal Revenue Service has refused to say if there is such a safe harbor, or if the Internal Revenue Service test also measures hours of employee time and coordinated volunteer efforts.

We don't know if there is an impact test where a big bang was achieved by relatively few dollars spent by a charity on one item of legislation.

Similarly missing from the Internal Revenue Service is some form of per se rule which specifies that, for example, an expenditure of 12 percent of the budget will, per se, justify revocation of the tax exemption.

You in the Congress began to address these problems in 1972, eventually passing legislation in 1976, which was to eliminate uncertainty in the administration of the lobbying rules by creating an option for election of definite amounts that could be spent in lobbying without penalty.

Today, since less than 1 percent of the public sector has elected to use those provisions, 501(h), the unmitigated failure of these rules to give the public sector what it asked for must be obvious.

I might add that 1 percent elected 501(h) before the promulgation of the proposed IRS regulations governing that section. The promulgation of these mean-spirited rules ends the charade that the

IRS believes that charities are meant to have a meaningful role in the debate on topical issues.

If these rules go into effect, I predict that no charitable organizations will elect to come under them, and that all the 501(c)(3) organizations will be back under the uncertainties of the substantiality test.

I believe the public, the Congress, would both be better served by a repeal of lobbying limits in 501(c)(3) and the repeal of its alleged attempt at liberalization.

Herbert Hoover said that a good many things go round in the dark besides Santa Claus. Congress need not be one of those things. One of the best ways to provide Congress with needed light is to make it as easy as possible for the public to communicate with Members of Congress in as many ways as possible.

One of the most efficient, enlightened, informed, and concise ways for the public to communicate with Members is through the charitable organizations which organize and channel the views of the public in diverse and important ways.

Public charitable groups, including churches, best exemplify the full range of opinions which can populate the marketplace of ideas. Today, labor unions and trade associations have a completely free hand to argue, cajole, and, on a partisan basis, make their points to Congress, using tax-exempt, tax-deductible dollars. Many other organizations receive government subventions of various kinds.

By contrast, my own organization receives no Federal subsidies. We do express the conservative and traditional views of hundreds of thousands of individual Americans who freely and voluntarily choose to support us on many topical matters. And we attempt to do so reasonably and responsibly.

It is unfortunate that our participation and the participation of other groups in the public debate may be subject to administrative intimidation on the one hand and is subject to uncertainty on the part of our donors on the other. They know that the Internal Revenue Service could at any time jeopardize their income or estate tax deduction retroactively through malign or even selectively benign enforcement of the lobbying rules. These are rules which cannot be gleaned from the public record, even by expert counsel.

In conclusion, Mr. Chairman, if all publicly supported organizations—right, left, and center—are free to participate in shaping public policy, how can the public itself be the loser?

Some Members of Congress may feel they have too much to read on too many issues. But like my friend, John Buchanan, I believe you have always benefitted from your own conscientious efforts to widen the debate, to give unheard voices a hearing and to distill from open, unfettered, and even antagonistic debates, the best approach to problems and the best avenues to satisfactory solutions.

Surely repeal of the lobbying rules would not automatically accomplish that desirable goal, but it would, I believe, signal a new openness, a welcomeness, if you will, to charities, to schools, to educational institutions, and to churches to assume a rightful role in the legislative arena.

And as Thomas Jefferson noted in his first inaugural address, "Error of opinion may be tolerated where reason is left free to combat it." Fifty years of fear, ignorance, and the habit of indifference can perhaps now be reversed, so that errors of opinion may be fought by institutions of independence, fair partisanship, and sensitivity to our national well-being.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Edwin J. Feulner, Jr., follows:]

Statement of
Edwin J. Feulner, Jr., Ph.D., President of
The Heritage Foundation
214 Massachusetts Ave., N.E.
Washington, D.C. 20002
202/546-4400

In response to Mr. Pickle's invitation to testify on behalf of The Heritage Foundation, I am pleased to respond to his direct inquiries and offer my personal comments about the political activity limits now in the Internal Revenue Code.

He asked:

"(1) to what extent does your organization undertake lobbying, and engage in political activities, and

"(2) whether you consider the current tax law applicable to lobbying and political activites of tax-exempt organizations to be appropriate to the needs of your organization."

The Heritage Foundation, as a research institution, does not engage in propaganda or otherwise attempt to influence legislation or engage in political campaign activities. We deal in the marketplace of conservative ideas and American ideals. We have no substantial role in what others do to translate our work into concrete legislative proposals nor do we seek to advance or inhibit pending or proposed legislation.

Saying that is not to say that we are necessarily in complete compliance with existing law. As the members of this Committee know, Section 501(c)(3) of the Internal Revenue Code provides that "no substantial part" of our resources can be devoted to lobbying activity. We don't know, nor does the Congress, nor does the public, what secret rules the Internal Revenue Service uses to determine what is "substantial."

Many 501(c)(3) organizations operate on the assumption that there is a "safe harbor" expenditure test of five percent of budget. However, the Internal Revenue Service has refused to say if there is such a "safe harbor," or if the Internal Revenue Service test also measures hours of employee time and coordinated volunteer efforts. We don't know if there is an "impact" test where a big bang was achieved by a few dollars spent by a charity on one item of legislation. Similarly missing from the Internal Revenue Service is some form of per se rule which specifies that, for example, an expenditure of twelve percent of the budget will per se justify revocation of the tax exemption.

Congress began to address these problems in 1972. You eventually passed legislation in 1976 which was to eliminate uncertainty in the administration of the lobbying rules by creating an option for election of definite amounts that could be spent in lobbying without penalty.

Since less than one percent of the public sector has elected to use 501(h), the unmitigated failure of these rules to give the public sector what it asked for is now obvious. I might add, that one percent elected 501(h) before the promulgation of the proposed Internal Revenue Service regulations governing that section. The promulgation of these mean-spirited rules ends the charade that charities were meant to have a meaningful role in the debate on topical issues. If these rules go into effect, I predict that no charitable organization will elect to come under them, and that all of us will be back under the uncertainties of the "substantiality" test.

I believe that the public, and the Congress, would be better served by a repeal of lobbying limits in 501(c)(3) and its alleged attempt at liberalization. Herbert Hoover said that a good many things go around in the dark besides Santa Claus. Congress need not be one of those things. One of the best ways to provide Congress with needed light is to make it as easy as possible for the public to communicate with Members of Congress in as many ways as possible. One of the most efficient, enlightened, informed, and concise ways for the public to communicate with Members is through the charitable organizations which organize and channel the views of the public in diverse and important ways.

Congressman Jack Brooks recently said:

"Public charities are the situs of an enormous wealth of expertise and information on matters of vital interest to this nation. To prevent these groups from sharing their expertise and information with the general public would be tragic. To prevent them from sharing their expertise and information with federal, state, and local legislators--the makers of this nation's policy--would be disastrous."

Public charitable groups, including churches, best exemplify the full range of opinions which can populate the marketplace of ideas. Today, labor unions and trade associations have a completely free hand to argue, cajole and, on a partisan basis, make their points to Congress using tax exempt/tax deductible dollars. Many other organizations receive direct government subventions of various kinds.

By contrast, The Heritage Foundation receives no federal subsidies. We do express the conservative and traditional views of hundreds of thousands of individual Americans on many topical matters, and we attempt to do so reasonably and responsibly. It is unfortunate that our participation in the public debate is subject to administrative intimidation on the one hand and uncertainty on the part of our donors on the other. They know that the Internal Revenue Service could at any time jeopardize their income or estate tax deduction retroactively through malign or even selectively benign enforcement of the lobbying rules. These are rules which cannot be gleaned from the public record, even by expert counsel.

In conclusion, Mr. Chairman, if all publicly supported organizations, right, left, and center, are free to participate in shaping public policy, how can the public itself be a loser? Some Members of Congress may feel they have too much to read on too many issues. But I believe you have always benefited from your own conscientious efforts to widen the debate, to give unheard voices a hearing, and to distill from open, unfettered, and even antagonistic debates the best approach to problems and the best avenues to satisfactory solutions. Surely repeal of the lobbying rules will not automatically accomplish that desirable goal. But it would signal a new openness -- a welcomeness if you will -- to charities, to schools, to educational institutions, and to churches, to assume a rightful role in the legislative arena.

As Thomas Jefferson noted in his first Inaugural Address: "Error of opinion may be tolerated where reason is left free to combat it." Fifty years of fear, ignorance and the habit of indifference can perhaps now be reversed so that errors of opinion may be fought by institutions of independence, fair partisanship and sensitivity to our national well-being.

Mr. FLIPPO. Thank you very much for your testimony.

Mr. Buchanan, your organization has both the (c)(3) and the (c)(4) committee, are these related to any other groups?

Mr. BUCHANAN. No, Mr. Chairman.

Mr. FLIPPO. And do you feel comfortable operating under current law with your (c)(3) and (c)(4), do you feel the definitions are adequate?

Mr. BUCHANAN. Yes, we do. We have no problems with the law as it is. We agree with Chairman Pickle in the decision about not having the proposed regulations discussed in this hearing. We do have problems with that interpretation of the law. We elected to form a 501(c)(4) for all the activities in which we engage that are lobbying type activities, and do not use 501(c)(3) funds for that purpose.

We feel, however, that there are many charitable organizations whose voices you really need to hear, who can operate within that 20-percent limit; and we have no problems with that basic policy, sir.

Mr. FLIPPO. Are you finding what you consider to be abusive use of tax-exempt organizations in the real world?

Mr. BUCHANAN. Well, I lack expertise on that subject. You do have——

Mr. FLIPPO. Let me rephrase it. Do you think we need more and better public disclosure of these organizations?

Mr. BUCHANAN. I would have no problem with maximum public disclosure.

Mr. FLIPPO. Thank you.

Dr. Feulner, does the Heritage Foundation have a related group?

Mr. FEULNER. We have one related group, Mr. Chairman. It is also a 501(c)(3) organization called the Heritage Institute. I am pleased to make its existence known. The primary purpose of that institution, which has basically been dormant since it was founded some 6 or 7 years ago, is to be available to accept a very large donation from some prospective donor, which might, were it to go straight to the Heritage Foundation, disqualify us as a public charity. I guess that with the size of our budget, such a donation would probably have to be about $90 or $95 million. So, we have not, unfortunately, had occasion to use the Heritage Institute.

We do not have a (c)(4) related organization or any other affiliated groups, however.

Mr. FLIPPO. Your organization then is primarily an educational organization?

Mr. FEULNER. Yes, sir.

Mr. FLIPPO. Do you feel that educational material can change into lobbying by the timing and circumstances of that education process?

Mr. FEULNER. No, sir. If the educational product fundamentally meets what the Internal Revenue Service calls the full and fair disclosure of the facts where reasonable people can arrive at different conclusions, I don't think that turns into lobbying. I think it's fundamentally information.

The fact that we try to make our information available in a timely fashion, I think is a credit to our ability to have this information available to Members, not only of the Congress, but other policymakers as well. I don't think it is lobbying; it is education.

Mr. FLIPPO. And I might pose the same question to you as I did to Mr. Buchanan. Are you finding in the real world out there what you consider to be abusive use of tax-exempt organizations?

Mr. FEULNER. No, sir, I have not. And I must—I again agree with my colleague, John Buchanan, in terms of the need for maximum disclosure. We spend a great deal of staff time and money making sure that we are in compliance with the 38 States and the District of Columbia that regulate charities. Our information is available in all these State capitols. We're audited annually by one of the big eight accounting firms. And I think all that information should be available as well in the sections of the 990 that are available.

The one problem, frankly, I would have in terms of disclosure is disclosure of donors. The demand for such a disclosure would probably have a chilling effect on certain donors. And again, that doesn't just apply to a Heritage Foundation, it applies to People For The American Way, to the American Civil Liberties Foundation, or whatever.

Mr. FLIPPO. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

I'd like to thank both of the gentlemen who are very familiar with the Hill for coming up today and presenting their testimony.

Mr. Buchanan, in your testimony you failed to mention the name of your 501(c)(4), was that any particular reason or——

Mr. BUCHANAN. No, not at all. It's People for the American Way Action Fund.

Mr. SCHULZE. And the name of your main organization is?

Mr. BUCHANAN. Is People for the American Way.

Mr. SCHULZE. People for the American Way. And the (c)(4) is People for the American Way Action Fund.

Mr. BUCHANAN. Action Fund. Yes, sir.

Mr. SCHULZE. One of our things that we're looking into is whether there's any confusion in this. Do you think that it could be somewhat confusing as to which group it would be contributed to or——

Mr. BUCHANAN. We tried to make it very clear. As I've indicated we have separate boards, bylaws and so forth. We have also separate stationery, when we send out, for example, a direct mail appeal from the People of the American Way Action Fund, it is on that stationery, and the purposes for which we're raising the money are made clear.

And we did a substantial amount of testing to make sure that people understood that this is not tax deductible money. It is primarily funded by smaller contributions.

Mr. SCHULZE. But in all of your literature when you're referring to one organization or another, do you use the full name?

Mr. BUCHANAN. Yes. If we are—in all correspondence, from one or the other, the full name would be used.

Mr. SCHULZE. Well, I mean, not necessarily in fund raising. What we're talking about is this sort of gray area. We had testimony yesterday that there were concerns about that. The reason I ask is that, in some of your literature that I've been given, your report on legislative activities from the People for American Way Action

Fund, you refer to the organization all the way through as People For, not People for American Way Action Fund. And today in testimony you referred to your organization as People For.

Mr. **Buchanan**. Yes.

Mr. **Schulze**. Do you refer to both of them as People For?

Mr. **Buchanan**. Well, we probably do. We honestly had no purpose to confuse or distort anything. We are very careful how we handle the money and what we use the money for, and we are regularly audited by one of the big firms as well, and would welcome any other examination of what we are and how we operate.

I guess the people who support us tend to support both entities, and to support the activities of both entities. They might contribute to one or the other. But I think most of us who are involved in our work are supportive of, in one way or another, both entities.

Mr. **Schulze**. You're saying, this is not a deliberate attempt to make one look like the other.

Mr. **Buchanan**. Oh, no, no.

Mr. **Schulze**. It just happens as the matter of circumstance. In other words, if you refer to both organizations as People For, you know, I think the average person has got to say that there's an opportunity there for a little bit of confusion. Would you agree to that or not?

Mr. **Buchanan**. To tell you the truth I hadn't thought about it. But we can certainly be more careful how we refer to the separate entities in the future. There is no hint of confusion as to how we handle the money, as to what we say to those who contribute to the two different funds. In all of that, we are very precise, though.

Mr. **Schulze**. Mr. Buchanan, you might be viewed as being on the left as this group we had yesterday, Channel—I forget the name of it—might be viewed as being on the right. There was some criticism or some questions yesterday about their advertising.

I don't have any copies of your advertising. But in your report you do refer to People For launched a massive lobbying and media campaign in opposition to the anticipated nomination; new radio and TV ads as well as in the public interest, tapes commentaries were distributed. Apparently, there's a lot of media orientation toward this. Is there any chance that we could have copies of that?

Mr. **Buchanan**. Certainly. All of that is 501(c)(4), not 501(c)(3), but, yes, you can indeed. Our founding chairman was Norman Lear who is a television producer, and we have used that medium. We are resisting forces that have used that medium. And therefore, we use it extensively, but it is 501(c)(4) money.

Mr. **Schulze**. I understand the organization that we were talking about yesterday has made full disclosure of the names of their contributors, but you say you would—you would rather not do that.

Mr. **Buchanan**. No, I didn't say that, Ed Feulner said that.

Mr. **Schulze**. You sort of indicated you agreed. Have you disclosed your——

Mr. **Buchanan**. We have disclosed all contributors to the (c)(4) to the Congress, as is required by law.

Mr. **Schulze**. I don't know that it's required by law.

Mr. **Buchanan**. I can't think of any.

Mr. **Schulze**. This other group has disclosed everything. I'm not fighting their fight for them, but I think that they voluntarily disclosed everything.

Mr. **Buchanan**. Well, let me try to correct——

Mr. **Schulze**. Whether there are any—do you have any——

Mr. **Buchanan**. We have nothing to hide. I will be glad to disclose contributors or anything else that you or the committee may wish. There is simply nothing there that we would have concern about.

There is a misconception, though. I will say to my old friend and distinguished Republican leader of this committee, we really are Republicans and Democrats. We're 30-percent Republican. Jerry Ford has been with us; Barry Goldwater has been with us; our executive director is somebody we obtained from the Republican Congressional Campaign Committee. We are bipartisan, and I will not resist the liberal label because I don't know what that means. I don't think there's anything more conservative than conserving the constitutional rights and liberties of American citizens.

And in that sense, I think we are as truly conservative as the Heritage Foundation. But I won't resist that identification.

Mr. **Schulze**. In the interest of a full disclosure, how would you recommend that the form 990 be improved or would you?

Mr. **Buchanan**. I'll turn to my general counsel, because I must confess, it's not something I thought about.

Mike.

Mr. **Hudson**. Mr. Chairman, the only thing I could add, and I am not a complete expert in this area, is that some form of disclosure, whether it's in the 990 or a separate form, seems to be reasonable and something we would have no problem with. Some other witnesses that know more about the tax law and the 990 have suggested that that wasn't the appropriate document. But, the idea of disclosing, either in the tax form or a separate document, we have no problem with that whatsoever.

Mr. **Schulze**. John, one more question. You said that your members do not sit on other boards?

Mr. **Buchanan**. Oh, no, no, no. I couldn't say that. I'm sure the members of our board sit on many boards.

Mr. **Schulze**. But (c)(3) and (c)(4) are separate boards.

Mr. **Buchanan**. They're separate boards, but Chairman Flippo asked if they are affiliated with other organizations in any way, and that is not the case.

Mr. **Schulze**. They may sit on other boards.

Mr. **Buchanan**. Yes, certainly so. And members of the 501(c)(3) board sit on the 501(c)(4) board, but it's not the same set of people.

Mr. **Schulze**. Mr. Feulner, I presume from your testimony that you feel that there is no need for a (c)(4) in your instance, you're just an educational institute, and you're not really responsible for what happens.

Mr. **Feulner**. That's right, Mr. Schulze, that's correct.

Mr. **Schulze**. You know, I'm inclined to agree, because you cannot really control a paper once you put it out, especially if it's viewed on an issue. Do you have any problems with GAO's definition yesterday when they were talking about section 4911(d) definitions?

Mr. FEULNER. Yes, I do, sir, and I'm glad you raised it because I think it shows the kinds of problems that those of us on this end constantly have. Ms. Stathis gave a very precise definition from section 4911(d) of the code of lobbying; and it appears to be quite certain and quite specific. But frankly, for 99 percent of the 501(c)(3) organizations, it is wrong. She failed to note in section 501(h)(7), the electing clause, that the IRS specifically prohibits using that precise definition for the 99 percent of the 501(c)(3) groups, like my own, that do not elect under 501(h). In other words, she's taking a definition there, predicating her whole testimony on it, and it doesn't apply to 99 percent of the 501(c)(3)s, because you have specifically said that it is not supposed to.

Now, you know, these hearings are going to be very important for the next 10 or 15 years to charities around the country, and if part of the U.S. Government testifies and gives us a wrong definition, you can imagine the kinds of problems we have out here on the receiving end.

Mr. SCHULZE. I thank you. Thank you, Mr. Chairman.

Mr. FLIPPO. Thank you.

Mr. Thomas.

Mr. THOMAS. Thank you, Mr. Chairman.

Dr. Feulner, just to close the question, has the Heritage Foundation ever actively sat down with its board and discussed a (c)(4) operation or has it not been a subject of discussion?

Mr. FEULNER. Mr. Thomas, no. To the best of my recollection we have never discussed that, because whether there is a Heritage publication that comes out, for example, for Teddy Kennedy's welfare program—we still have very strong indications from our last IRS audit that we would not violate the substantiality provision, so there would be no need for a (c)(4) entity.

Again, we are in the business of educating the policymakers.

Mr. THOMAS. John, welcome.

Mr. BUCHANAN. Thank you, sir.

Mr. THOMAS. You had the People for the American Way first; is that correct?

Mr. BUCHANAN. Yes.

Mr. THOMAS. What led you to decide to go to a (c)(4) operation?

Mr. BUCHANAN. We felt we needed to engage more extensively in lobbying activities than we could feel comfortable about with the limitation of the 501(c)(3) status, and we didn't want to endanger that basic status by getting close to the line. So, we thought it was better just to separate that function.

Mr. THOMAS. In separating and initiating the 501(c)(4), did you separate staff that you had under the (c)(3) to create the (c)(4)? How did you get the separate structure started?

Mr. BUCHANAN. Now, Mike Hudson may have to help me here, but I believe that certain people work only for the 501(c)(4), and others only for the 501(c)(3).

Mr. THOMAS. Did you hire a whole new group——

Mr. BUCHANAN. No, no, no. We transferred some. And again, there are board members who serve on both.

Mr. THOMAS. Is there any shared office space or are they completely separate as well as office space?

Mr. **Buchanan**. On the books the necessary adjustments are made. We share the same space, but the payments are made——

Mr. **Hudson**. The (c)(4) actually pays for the space and facilities that are shared. A very, very careful accounting and purchase of any shared services by the (c)(4) are made.

Mr. **Thomas**. And so, are there then employees that perhaps on a time sharing basis would handle both (c)(3) or (c)(4)?

Mr. **Hudson**. Yes, sir. We went through every single staff person, both new and old, to account for and break out any time that they might be spending on the (c)(4), and for that time they are paid from strictly (c)(4) funds.

Mr. **Thomas**. And in terms of solicitations that may come in on a basis of mailings, what I call a caging operating, in terms of retrieving the checks and the rest of the material, is that done on a shared time basis as well? I assume you send out mailings for the (c)(3) and for the (c)(4) and they would be coming in.

Mr. **Hudson**. Yes, sir. But basically, all of our direct mail is done by the (c)(4), and it is not advertised or indicated in any way that those gifts are tax deductible. It is processed as a (c)(4) activity.

Now, some of our other donations that are tax deductible are handled in the (c)(3). So, it is divided.

Mr. **Thomas**. If someone sent a check in, and I'm reacting to Mr. Schulze's examination of testimony in which People For seems to be the emphasis, and I know that we're all very explicit on the cards that we send out for solicitations indicating, "make funds payable to", and I'm sure it says, People for the American Way Action Fund. What would happen to a check that came in that said simply, People For?

Mr. **Hudson**. In many, many cases we will call our contributor and ask their intention, and if they intended it to be a People For contribution, that is the way it's——

Mr. **Thomas**. People For, which one, they're both People For?

Mr. **Hudson**. People for the American Way, excuse me, sir.

Mr. **Thomas**. You say, in many, many instances; what about in those instances that aren't included in the many, many?

Mr. **Hudson**. Well, we check it out anywhere it's not clear.

Mr. **Thomas**. Okay. But you say, in many, many instances. In all instances, is what you meant to say.

Mr. **Buchanan**. Yes. I think that if you send a substantial—all major contributions go to the People for the American Way, 501(c)(3), coming from the mail. There are other ways we raise money. And much of the People for the American Way money is raised other than through direct mail.

Mr. **Thomas**. I understand. It's just that my concern. I've seen many times in political activities, and these are political activities in which you sometimes have to play Solomon as to what the people meant.

You're saying that in every instance you have an opportunity to play Solomon that you call them to find out whether they meant to send it to the 501(c)(3) People for the American Way or the 501(c)(4) People for the American Way Action Fund.

Mr. **Buchanan**. And that's very important to us institutionally, you know. First of all, we really want to live within the requirements of and protect our 501(c)(3) status.

Second, we want to play fair with our members. I mean, as to whether they intended to give a tax deductible contribution.

Mr. **Thomas**. Was there ever a situation in which you made a mistake in disbursing the funds between the two? Do you ever recall a situation?

Mr. **Hudson**. No, sir, not that I know of. We've had some inquiries about how the gift is recorded. We've always straightened it out. I don't think there's ever been a mistake made, not that I know of.

Mr. **Buchanan**. I'm going to say in all candor, when we began this I had many of the same concerns you are expressing here, and we've tried very hard to make these delineations so that we were sure that the contributor understood to which he was giving and the money went into that organization.

Mr. **Thomas**. I fully understand why you want to use the same name, because if you've invested that time and energy and recognition, you don't want to come up with a completely different name. But given the close similarity, I'm sure your bookkeeping at times must be very strenuous to make sure that you maintain the clear demarcation.

Thank you, Mr. Chairman.

Mr. **Flippo**. Thank you.

Dr. Feulner, let me ask, you're aware I'm sure that some 501(c)(3) use your educational material in their publications or links your's in a rather prominent way. Who pays for that—do you pay for the printing that's included in that 501(c)(3) publication or does the Heritage Foundation pay for the printing of those materials or does the—do you give them permission to use your material?

Mr. **Feulner**. We give blanket permission to anyone to use any of our material, as long as they give us credit. Mr. Chairman, on occasion, working with other 501(c)(3) organizations, we have run an extra 5,000 copies of a particular lecture or something, and given it to those organizations; that's always done on a case-by-case basis, and it is only done with 501(c)(3) organizations.

For example, we may print a lecture that another group might want to get out to college students—not one of our normal target audiences.

Mr. **Flippo**. I guess others would probably follow a similar—would Brookings Institute, for instance, follow a similar policy? Do you—what I'm trying to get to, do you give specific clearance for the use of your material or do you give blanket?

Mr. **Feulner**. We give blanket clearance whenever it's requested, sir, and that extends from USIA for publication overseas, to the Library of Congress, to other organizations.

Mr. **Flippo**. If a political 501(c)(3) provision requested to use your material and you pay for that sometimes?

Mr. **Feulner**. No, sir, we don't pay for it, but we would give them permission to use it. Because our material, again, is educational in nature.

Mr. **Flippo**. Mr. Dorgan.

Mr. **Dorgan**. Thank you, Mr. Chairman.

I missed most of the testimony, although I've browsed through part of it. I have just one question, and it's not so much for you specifically, Mr. Feulner, but it would apply to Heritage, Brookings, and others.

In the area of economics, foreign policy and others, you can find folks who will come down on almost any side of any question in a seemingly informed way. I have felt from time to time over the years that I've served here that there are occasions when people will distribute educational "material" that was just announced and just published days or hours before a critical vote, supporting either a liberal or conservative cause. All of this is done with a straight face, as if this group were really working on this educational material and it just happened to be released the day before an important vote in Congress on that very issue.

Where does education stop and propaganda start with respect to the timing of these things, and with respect to the inclination of some, not necessarily the Heritage Foundation, to join hands with those who want to support a certain cause and develop information to help in that process?

Mr. FEULNER. It is, of course, a very fine line, Congressman. I would maintain, however, that we are caught, in effect, in a box. If we produce a paper on welfare reform that is not topical, no one will pay any attention to it. If we produce a paper on welfare reform the day after the key vote takes place, we churned a lot of paper and we made some librarians in some university libraries probably busier, but we have in fact not helped in terms of the educational process.

I think, as I said in my prepared statement, that those of you on the receiving end can pick and choose from the wide range of options that you receive in terms of educational material. And we try very hard to meet what the IRS calls the full and fair disclosure requirements, that is, we put it all up front in terms of the facts; yes, arrive at a conclusion, but presumably reasonable people could arrive at other conclusions based on the facts up front.

Mr. DORGAN. One could, obviously, form an organization that would be tax-exempt and educational in nature with the sole purpose of supporting the funding of the Contra soldiers, and which would distribute educational and informational material that would be strategically placed in time to coincide with and support certain legislative initiatives. That's certainly possible, and I assume probably does happen occasionally.

Mr. FEULNER. It is conceivable.

Mr. DORGAN. I was thinking about your holding up your support of Senator Kennedy's initiative. If you were simply to dig in random in your files over there, would you be likely to come out with something that's supportive of Senator Kennedy's position?

Mr. FEULNER. How about a Heritage lecture delivered by Congressman Atkins?

Mr. DORGAN. Let me just say that I find much of what your organization puts out informative and interesting. I think there is an interesting discussion to be had about where the line is drawn between what's purely educational and what is motivational propaganda in a number of organizations. I appreciate your being here, and appreciate being able to read the testimony of both of you.

Mr. FEULNER. Thank you, sir.

Mr. BUCHANAN. Thank you.

Mr. Flippo. Thank you very much for your testimony.

Mr. Buchanan. Thank you, Mr. Chairman.

Mr. Feulner. Thank you, Mr. Chairman.

Mr. Flippo. It will be very helpful.

Our next panel, we have Jackie Strange who is the president and CEO of the Dole Foundation for the Employment of Persons with Disabilities. And we have a distinguished former Member of the House and of this committee, Martha Keys, who is the executive director of the Center for a New Democracy. And we have John Wallace, who is the counsel for the Democratic Party of North Carolina.

Would you please join us at the witness table. And we're delighted to have you here, and we hope your—we know your testimony will be presented in full in the record. We would like for you to summarize as briefly as you deem appropriate. And you may proceed as you deem appropriate as well.

STATEMENT OF JACKIE A. STRANGE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, THE DOLE FOUNDATION FOR THE EMPLOYMENT OF PERSONS WITH DISABILITIES, ACCOMPANIED BY JEANNE ARGOFF, GRANTS PROGRAM MANAGER

Ms. Strange. Thank you, Mr. Chairman. My testimony has been submitted, and I ask that it be made part of the record, please.

Mr. Flippo. It will be made part of the record. Thank you.

Ms. Strange. I am president and chief executive officer of the Dole Foundation for Employment of Persons with Disabilities.

May I say up front that I have been in this position exactly 9 days, but I do have a life commitment to the purpose of the organization, and I'm proud to be serving in this capacity. I have been very actively involved in programs for the handicapped, leaving the position of Deputy Postmaster General with the Postal Service we had perhaps the strongest Federal program for the handicapped. So, it is something that I'm very familiar with, and a life that I am committed to.

Today I want to discuss the Dole Foundation with you, but before that I want to share with you what I think are some very startling facts about the disabled.

The 1980 census shows that 22 million Americans over the age of 16 have work disablities; of that 22 million, almost 13 million of those are of working age, and 6.2 million tell us that they have been prevented from working because of their disability.

Something that is even more disturbing and presents a darker picture comes from a recent Harris poll which shows that 8.2 million Americans who want to work state that they have been prevented from working because of disabilities.

I think that we cannot evade our responsibility as Americans, and that we must face a moment of truth. While numbers can be misleading and can be cold and stark, we must acknowledge the fact that we have millions of Americans across this nation who face unemployment because we fail to remove barriers of a social and physical nature, and also, because there are many who have no regard for the problems of the disabled.

The Federal Government, we are told, spends more than $60 billion annually for benefits and programs for the disabled. If we can assist the disabled in becoming economically independent, and they can become taxpayers, then I think that we all win.

We all agree that disabled persons need to work. They can work. And they should be given an opportunity to work. And you and I both have a responsibility for making this happen.

The Dole Foundation for Employment of Persons with Disabilities is a nonpartisan tax-exempt nonprofit 501(c)(3) organization whose mission is solely to promote economic independence of persons with disabilities. We are not a political foundation nor are we engaged in lobbying or advocacy activities.

It is true that some of the people who receive grants from us perhaps do lobby. But we do not provide funding for lobbying or for general purposes. Every dollar that we award is specifically earmarked for specific education, training, or placement programs; and we live by this criterion and do not use any other criteria when approving grants.

The Dole Foundation was created in 1984 by Senator Bob Dole as a means of returning to society the same type of rehabilitative support that he received in Russell, Kansas and from across the Nation during his struggle for life, during and after World War II.

We are a passthrough organization which raises funds from corporations and individuals, and in turn gives grants to community-based organizations who qualify. We are the only organization of this kind who crosses all lines of disability, and attempts to fill the gap between State and Federal funding to meet the needs of the disabled.

We have a 17-member board of trustees chaired by Senator Dole and cochaired by Robert Strauss. We have a very diverse membership that gives us national scope of vision. In addition to that we have a seven-member technical advisory committee. These people are experts in various subfields within the field of disability and employment. We feel that we have a very good balance between the public and the private sector. We have all areas of expertise represented on this committee.

Our sole purpose is to provide financial assistance to community-based organizations for training and employment of the disabled. In our brief 2½-year history we have a very successful track record. We've given grants of over $1 million to 43 community-based organizations. But, gentlemen, that is not enough.

For instance, in 1986 alone we received over 300 proposals representing millions of dollars from across the Nation.

Who wins by the efforts of the Dole Foundation? The disabled certainly, and the family members who serve as a support system to them. And the taxpayer when these people become economically independent.

The most important thing is that we've improved the quality of life for human beings, and for their families, as they then become able to make a contribution to society.

Our mission goes far beyond politics. It centers on the individual rights of the disabled to become independent, to gain self-respect, and to realize their full potential; a right, gentlemen, which you and I tend to take for granted every single day of our lives.

[The prepared statement follows:]

TESTIMONY OF JACKIE A. STRANGE
PRESIDENT AND CHIEF EXECUTIVE OFFICER OF
DOLE FOUNDATION
For Employment of Persons with Disabilities

SUBCOMMITTEE ON OVERSIGHT, COMMITTEE ON WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES

My name is Jackie A. Strange, President and Chief Executive Officer of the Dole Foundation for Employment of Persons with Disabilities. I should say at the beginning of this testimony that I have only been operating in this capacity since March 2. However, through the years I have gotten to know several members of this committee in my capacity as Deputy Postmaster General of the United States Postal Service, where I was also actively involved in the program for disabled employees. I am here today to discuss the mission of the Dole Foundation in relation to this subcommittee's investigation of the current law applicable to lobbying and political activities of tax exempt organizations. But first, let me give you some startling statistics.

Statisticians argue about the precise number of Americans with disabilities. Some estimate 20 million, and others go as high as 50 million, with 36 million being the most commonly quoted figure.[1] In the 1980 Census, over 22 million Americans over the age of 16 reported having work disabilities--and 12.9 million of those people were of working age. A total of 6.2 million reported that they were actually prevented from working by their disability. A newly released Harris poll commissioned by the International Center for the Disabled and the National Council on the Handicapped states that there may be as many as 8.2 million Americans who want to work but who are prevented from doing so by their disability.

Statisticians argue about numbers--and we all know how misleading numbers can be. There is, however, one major point that is beyond argument, and that is that there are millions of working-age Americans who have physical or mental disabilities that create barriers to their full participation in community and national life. While some of those barriers are direct results of their disabling conditions, the major stumbling blocks are not created by the disabilities themselves. An international panel of experts agreed that the major obstacle is society's failure to recognize and remove the social and physical barriers imposed by our less than full regard for the rights and abilities of people with impairments.[2]

We all suffer when people with disabilities are not given their full opportunity to work. The Federal government alone spends over $60 billion a year on disability benefits and programs. When these persons with disabilities attain greater economic independence and become taxpayers, support costs drop dramatically.

These disabled citizens need to work and can work. They are supported in entering the labor force by local, community-based organizations. It is primarily these organizations--which provide services related to job development, recruitment, training, placement, post-placement follow-up, career enhancement, and improved employer responsiveness--that the Dole Foundation assists with funds.

Now, what is the Dole Foundation, and what does it do? The Dole Foundation for Employment of Persons with Disabilities is a nonpartisan tax-exempt not-for-profit 501(c)(3) organization, whose mission is to promote the economic independence of persons with disabilities. It is not a so-called "political foundation," nor does it engage in lobbying or advocacy actitivies.

The Dole Foundation was created in 1984 by U. S. Senator Bob Dole as a means of returning to society the type of rehabilitative support he received from his hometown community, Russell Kansas, during his own struggle with disability following World War II.

We are a "pass-through" organization, which raises funds on a national level from corporations and individuals, and in turn awards grants to qualified local nonprofit organizations throughout the United States that operate innovative programs to help disabled Americans gain economic independence.

The Dole Foundation is governed by a 17-member Board of Trustees, chaired by Senator Dole. Our Vice Chairman is Robert S.Strauss. The Board's diverse membership reflects a balance of public and private sector interests and represents a range of political affiliations that gives the Foundation a national scope of vision which enables it to maintain a broad focus on local, community-based programs.

Additionally, a seven member Technical Advisory Committee composed of experts in various fields of disability and employment reviews grant proposals in depth, is available to conduct site visits to grant applicants when necessary, and makes funding recommendations to the Board of Trustees.

Both our Board of Trustees and our Technical Advisory Committee are carefully composed to enable us to carry out our one and only purpose--to provide financial and substantive assistance to help people with disabilities in their attempts to obtain work. That, together with the fact that our grantmaking encompasses programs for people with all types of disabilities, makes us unique. Other foundations focus on a specific disability or include training and employment programs for people with disabilities as one of many program areas.

Grant recipients providing employment and training programs vary considerably. The range includes career fields as diverse as foodservices, computer programming and operation, banking, horticulture, communication arts and light industrial production.

A large number of our grantees provide a wide spectrum of services to people with disabilities--including residential programs, vocational rehabilitation, job training and placement, counseling, education, information, and referral. Some of these groups also include advocacy among their services and activities. The type of advocacy engaged in by these groups is focused on removing those social, physical, and attitudinal barriers I spoke of earlier as hampering the full participation of people with disabilities in the life of their communities.

While some of our grant recipients do engage in lobbying activies in support of this obviously worthy cause, the Foundation does not provide grants for lobbying or for general purposes. All of the funds we distribute are earmarked for specific education, training, and placement programs with the very practical purpose of moving disabled individudals into community-based employment.

During its brief 2 1/2 year history, the Dole Foundation has achieved a remarkable track record. Corporate and individual support has enabled the Foundation to award grants totalling $1,150,000 to 43 local organizations around the country.

Generally, the size of grants awarded range from $5,000 to $50,000, with emphasis on funding "model projects" and providing "start-up" funding for one year. It is expected that after one year these programs will have proved their merit and the organizations operating them will be able to get continued funding from more traditional sources in future years.

We awarded $250,000 in our last round of grants and expect to increase that amount in each new grant cycle. But, the need greatly exceeds our current capabilities. The Foundation has raised well over $2 million in its brief existance, but last year alone we received almost 300 funding requests totalling many millions of dollars.

It is important to note that people with disabilities are not the only ones who benefit from Foundation support. Millions of family members share the reward of seeing their disabled loved ones living fuller and more independent lives once they become employed.

Equally significant are employers who open their doors to disabled workers - based on each individual's ability rather than disability - and thus gain access to a broader base of qualified employees. Involved employers are quick to tell you that hiring persons with disabilities also often motivates other workers.

Another end result is a tax savings for all Americans. It is an obvious fact that we all win when people with disabilities become taxpayers themselves rather than having to rely on other taxpayers to provide them with unemployment benefits.

Tax savings for the American people, strengthened family lives, and a more productive work force for all of us are the ultimate achievements when Americans with disabilities are given the chance to work. The mission of the Dole Foundation is to help those people and their families improve the quality of their lives and the contribution they can make to society. It is a mission that goes beyond politics and centers on the individual rights of all people to become as independent as possible and to realize their full potential.

NOTES

1. National Council on the Handicapped, Toward Independence: a Report to the President and to the Congress of the United States (Washington, D.C.: GPO, 1986), p.3.

2. Report of the United Nations Expert Group Meeting on Barrier-Free Design, International Rehabilitation Review, vol 26 (1975), p.3.

Mr. FLIPPO. Thank you for your testimony.
Martha.

STATEMENT OF HON. MARTHA E. KEYS (FORMER MEMBER OF CONGRESS), EXECUTIVE DIRECTOR, CENTER FOR A NEW DEMOCRACY

Ms. KEYS. Thank you. And it's nice to be here with the committee again.

Mr. FLIPPO. It's so nice to see you.

Ms. KEYS. I'm very pleased to testify, really, at the request of the subcommittee staff, and happy to cooperate and want to commend and congratulate this committee on holding these oversight hearings. I think the 501(c)(3) tax law is an appropriate law. I'm very glad that the tax law encourages organizations that work appropriately within the confines of that law. And yet, I think it is absolutely necessary that the public knows that there is an oversight function being carried out by Congress; and that every attempt is being made to assure that organizations that are living within that law do operate appropriately under that law.

There have been a number of questions raised, certainly in the climate of the last year, and I think it's appropriate and commendable that this work is being done.

I think the public interest is well served by the 501(c)(3) tax law in its broadest scope, but I'd like to speak very briefly and personally about my experience, because in the past 2 years I've had the amazing and intensive challenge of really developing and directing a new policy center, a 501(c)(3).

I do believe that, as it was so well articulated by Congressman Rangel, a member of this committee, and Senator Durenberger of the other side of the Hill, just a couple of years ago, I believe, in an address to the Council on Foundations, there is a tremendous need of investment in public policy research and development, particularly at a time such as we have now, a rapidly changing conditions and economic transition.

We have in our work tried to address that. We have a 12 person board who have been very active in directing the program and activities of the center, and it has certainly been a challenge to be able to work with all of the board members and advisers to the center, and those who joined in the early stages to help it be founded.

I do want to address one rather sticky question, because I think there has been some real concern, and certainly legitimate concern about 501(c)(3)'s that are founded or somehow closely associated with a political leader. I do believe that there has to be a stricter safeguard and full insurance that the public interest is being served by such. There's certainly a long heritage of tremendous contribution accomplished by such organizations in which a national leader has used their prestige to found a 501(c)(3). We've just heard the testimony of one such before, and they certainly date back, perhaps, to President Roosevelt's founding of the March of Dimes. Because I have always agreed that public leaders have greater responsibility, I do believe that, at the very least, this has to be met with some kind of response. We have done it at the

Center for New Democracy by having full disclosure of our contributors and of our receipts and expenditures. And indeed, I think this is a basic requirement that ought to apply to, certainly, a 501(c)(3) connected in any way with a Member of Congress or a political figure.

And, in fact, I—dating back to some discussion and some votes cast on this committee, in the dim dark past when I served on it, frankly, feel that that is not too much to request of any 501(c)(3), but that is my own personal opinion.

At any rate, I would like to submit just for the record what we have done at the Center for New Democracy in terms of this disclosure in an annual report, in the hopes that it might be helpful as the committee is looking at all of the questions surrounding 501(c)(3), and the guidelines that can be established that can answer any questions or doubts that public or others might have about such organizations.

I'm certainly happy to be here. I'll be glad to answer questions.

[The prepared statement and attachments follow:]

TESTIMONY OF THE HON. MARTHA KEYS
EXECUTIVE DIRECTOR, CENTER FOR A NEW DEMOCRACY
before the
OVERSIGHT SUBCOMMITTEE
HOUSE WAYS AND MEANS COMMITTEE
MARCH 13, 1987

I am pleased to appear before members of this Subcommittee at the request of Subcommittee staff.

Both as a former colleague on the House Ways and Means Committee and as the Executive Director for the past two years of a 501(c)(3) research and education organization, I have given a good deal of thought to the matters with which you are concerned today.

To summarize, I believe the tax law is appropriate in its encouragement of research and educational organizations, and that the public interest is well served by organizations that conduct research, seminars, conferences and produce publications about the critical problems of our times and their solutions. The public interest is well served by the ability of such work to take the long-range view, to explore new options and to allow a wide range of experts to work together to develop solutions. And I agreed with Congressman Rangel of this Committee and Senator Durenberger when they spoke to the Council on Foundations about the necessity of investment in national policy development.

I am aware of the concern that has been expressed by some about 501(c)(3)s associated with political leaders and do believe it is important to assure the public that these institutions are operating in the public interest and not used for political ends. The Center for a New Democracy has a policy of disclosing both its contributors and a financial report of its receipts and expenditures in an annual report. I would recommend this as a reasonable requirement for all 501(c)(3)s founded by or closely associated with a political leader.

While the strictest safeguards should be instituted to guard against abuse; however, it is also important to note that research centers associated with political leaders can make an important contribution to the public policy debate. Policy findings are often particularly relevant and useful partly because they have been enriched by contact with the real-world of public policy and partly because the ability to attract a wide range of expertise in both private and public sectors is enhanced.

I am happy to submit to this Subcommittee an overview of our Center activities and our annual report, in the hopes that they can be useful in establishing guidelines for 501(c)(3) behavior.

And I will, of course, be pleased to answer any questions you might have for us, both now and in the future.

Center
for a New
Democracy

Founders
Gary Hart
Diane Meyer Simon
Herbert Simon
Tabitha King
Stephen King
Stuart Karl
Don W. Carlson
Don D. Montgomery, Jr.
David Stein
William H. Watson
Ronald I. Dozoretz
Stewart Bainum, Jr.
Micky Miller
John Barnes
Marilynn Gersten
Albert Gersten, Jr.

Board of Directors
Gary Hart
Yvonne Braithwaite Burke
John Holum
Joel Hyatt
Rosabeth Moss Kanter
Regis McKenna
Don D. Montgomery, Jr.
Raymond Orbach
Federico Pena
Robert B. Reich
Theodore C. Sorensen
Susan J. Williams

Council of Advisors
Roger C. Altman
Milner S. Ball
Kingman Brewster
James MacGregor Burns
Pat Choate
Edwin A. Deagle
Sidney D. Drell
Jack DuVall
Ralph Earle II, Esq.
Carroll L. Estes
Shirley M. Hufstedler
Paul E. Peterson
Ronald K. Shelp
Larry K. Smith
Barry A. Stein
Lester C. Thurow
Laurence H. Tribe
Daniel Yankelovich

Executive Director
Martha Keys

220 I St., NE Suite 220
Washington, DC 20002
(202) 675-6050

CENTER FOR A NEW DEMOCRACY - OVERVIEW

The Center for a New Democracy is a nonpartisan, non-profit policy center founded in early 1985 to develop a new governing program for an America undergoing a profound transformation as it enters an increasingly post-industrial, interdependent, multipolar, and nuclear world. The Center is seeking answers that transcend traditional liberal and conservative orthodoxies. Its founders believe that policymaking in this time is too important to be left to its traditional practitioners and that broader participation is essential to mobilize the full range of American talents, resources, creativity, industry and imagination, and bring them to bear on the challenges at hand.

The Center is distinguished by its focus on finding solutions to this era's key challenges and involving people around America in its work. Thus the Center sponsors a wide variety of conferences, seminars, publications and studies on economic, social, and international concerns. (See attached "Center Projects")

THE CENTER - ACCOMPLISHMENTS

One and a half years old, the Center has:

- held 6 seminars on macroeconomic and workplace issues in a series titled *The New American Economy: New Problems, New Approaches;*
- held two major international conferences of multipartisan leaders from a dozen Pacific countries;
- launched a major participatory effort with people around the country to design a *Strategic Investment Initiative;*
- held an education seminar in South Carolina;
- developed a membership network of 1500 and a quarterly mini-magazine, *New Realities;* and
- developed *CenterLink*, the nation's first electronic policy network.

Organizational co-sponsors of our seminars and conferences have included Harvard-East Asia, UCLA Center for Pacific Studies, United Airlines, The Bildner Center of CUNY, The Urban Research Center of NYU, 9 to 5 Association of Working Women, Cleveland State University College of Urban Affairs, Downriver Community Conference, TEXANE, The World Policy Institute, Atlanta World Trade Club, and Booz-Allen & Hamilton.

THE CENTER - FUNDING

The Center's annual budget of approximately $500,000 is provided by individual, corporate, and foundation donors. The Center is a 501(c)(3) organization and contributions are tax-deductible. Among the institutional donors who have contributed to Center activities are: The Rockefeller Foundation, ARCA Foundation, Tides Foundation, Blum-Kovler Foundation, American Express, Bank of America, The Pillsbury Company, Amoco Corporation, Bell & Howell, Intel, Pacific Telesis, and Republic National Bank.

CENTER FOR A NEW DEMOCRACY PROJECTS
1985-1987

The New American Economy Seminar Series

The Center for a New Democracy's economic seminar series, "The New American Economy: New Problems, New Approaches," was a major focus in the Center's first year of activity. Dealing with the challenges of trade, debt, modernization, the changing family's impact on the workplace, and displaced workers, the series was designed to highlight innovative solutions to the major macroeconomic and workplace challenges of our time. Seminars were held in Washington, Atlanta, New York, Dallas, Cleveland, and Detroit, and involved representatives from both the private and public sectors - labor and management, Republicans and Democrats, policy specialists and community leaders.

The Center has published and is widely disseminating "Action Agendas" summarizing the innovative policy proposals discussed at the seminars, and is planning a final teleconference in 1987 to share the results with thousands of Americans around the country interested in understanding the New American Economy.

The New American Community Focus

During its second year, the Center for a New Democracy will examine and focus on building "The New American Community." It will attempt to highlight efforts at the local and regional level to revitalize America and its communities, and will seek to identify *strategic domestic investments* needed to encourage individual and community independence and growth. The goal of the series is to rebuild the societal consensus necessary to help all Americans meet the challenges of the future.

A first seminar, "Education in the New American Community: Changing Challenges, Changing Solutions," was held in South Carolina in mid-October, and focused on that state's innovatives in school reform and its remarkable success story in meeting today's educational challenges.

International Conferences

In 1985 and 1986, the Center sponsored major international conferences on issues confronting Pacific Rim nations. The conferences - held in Los Angeles and Seoul - brought together more than 40 multi-partisan Pacific Rim leaders and featured speeches by such leaders as the Chinese Ambassador to the United States, Han Xu, Richard Holbrooke, and Sen. Gary Hart. Session summaries and final reports were prepared, and disseminated.

Strategic Investment Initiative

Over the next several months, the Center will be devoting significant resources to involving thousands of Americans in the development of a *Strategic Investment Initiative*. The purpose is to identify the key investments the United States must make over the next five years to regain the world's finest workforce and technology base by the year 2000. The initiative is based on the premise that the United States cannot afford everything, and must carefully select those key investments necessary to guarantee economic strength by laying the foundation for growth in the post-industrial world economy. It will detail critical investments needed in education, job training and retraining, and research and development with a particular emphasis on the commercialization of new technologies.

CenterLink

The Center will soon be launching *CenterLink* - the nation's first electronic policy network. The basic idea of the network is to link tens of thousands of people via personal computers and telephones in an effort to develop democratically a post-New Deal and post-conservative program. CenterLink will be the sole network in the country to provide access to information on all the key issues of our time, rather than a particular category. We feel this will both enhance its reputation for objectivity and achieve a basic goal: to be the first place people call when they need information about a given issue. The most exciting aspect of CenterLink though is its interactive component. It is our belief that over the next several years large numbers of Americans will use asynchronous computer conferencing to become *inter*-actively involved in the policy decisions that so critically affect their lives. In addition to assisting in the development of Center projects, citizens will participate in the *Citizens Policy Action Exchange*, the online development of CenterLink's database.

Other Projects

The Center received a significant grant from the Arca Foundation to conduct a comprehensive study of *national service*. The study will examine the wide variety of programs currently providing American youth with the opportunity to serve their nation, including state and local conservation corps, campus-based service organizations, high schools with service requirements, and the Peace Corps, the military, and other federal programs. The Center is seeking support to underwrite the on-site research and writing of a major publication that would, in readable language and attractive format, provide a comprehensive survey of the grassroots support for the idea of national service.

In conjunction with the 40th anniversary of the establishment of the Central Intelligence Agency, the Center is planning a conference examining the CIA's origins, the evolution of its role and mission, and its direction in the coming years.

Publications

The Center for a New Democracy has a number of publications available to interested citizens at cost. These include its theme-oriented, quarterly mini-magazine, *New Realities*; the transcripts and Action Agendas of the New American Economy seminar series; the final report of the Pacific Rim conference; and several *Policy Resource Outlines* (PROs), the hard-copy version of CenterLink's database.

* * *

The greatest accomplishment in the past year is the establishment of the Center for a New Democracy not as a Washington, D.C.-based think tank, but as an interacting network of thinkers and doers from around the nation. Those who have been actively involved in the Center family and the policy development process number far more than our Founders and Board of Directors, and include:

- a Leadership Council of 64
- a Membership Network of over 1500
- our Council of Advisors
- a growing group of people around the country who have volunteered time on Center projects and events
- the hundreds of people active in audience discussions
- the legion of private sector leaders, state and local government officials, academics and citizens who have advised and consulted with us in the planning of projects and seminars.

In addition to our staff of seven, we have had a series of fine interns who have spent time assisting us in coordinating these efforts.

CenterLink

The Center will soon be launching *CenterLink* - the nation's first electronic policy network. The basic idea of the network is to link tens of thousands of people via personal computers and telephones in an effort to develop democratically a post-New Deal and post-conservative program. CenterLink will be the sole network in the country to provide access to information on all the key issues of our time, rather than a particular category. We feel this will both enhance its reputation for objectivity and achieve a basic goal: to be the first place people call when they need information about a given issue. The most exciting aspect of CenterLink though is its interactive component. It is our belief that over the next several years large numbers of Americans will use asynchronous computer conferencing to become *inter*-actively involved in the policy decisions that so critically affect their lives. In addition to assisting in the development of Center projects, citizens will participate in the *Citizens Policy Action Exchange*, the online development of CenterLink's database.

Other Projects

The Center received a significant grant from the Arca Foundation to conduct a comprehensive study of *national service*. The study will examine the wide variety of programs currently providing American youth with the opportunity to serve their nation, including state and local conservation corps, campus-based service organizations, high schools with service requirements, and the Peace Corps, the military, and other federal programs. The Center is seeking support to underwrite the on-site research and writing of a major publication that would, in readable language and attractive format, provide a comprehensive survey of the grassroots support for the idea of national service.

In conjunction with the 40th anniversary of the establishment of the Central Intelligence Agency, the Center is planning a conference examining the CIA's origins, the evolution of its role and mission, and its direction in the coming years.

Publications

The Center for a New Democracy has a number of publications available to interested citizens at cost. These include its theme-oriented, quarterly mini-magazine, *New Realities*; the transcripts and Action Agendas of the New American Economy seminar series; the final report of the Pacific Rim conference; and several *Policy Resource Outlines* (PROs), the hard-copy version of CenterLink's database.

* * *

The greatest accomplishment in the past year is the establishment of the Center for a New Democracy not as a Washington, D.C.-based think tank, but as an interacting network of thinkers and doers from around the nation. Those who have been actively involved in the Center family and the policy development process number far more than our Founders and Board of Directors, and include:

- a Leadership Council of 64
- a Membership Network of over 1500
- our Council of Advisors
- a growing group of people around the country who have volunteered time on Center projects and events
- the hundreds of people active in audience discussions
- the legion of private sector leaders, state and local government officials, academics and citizens who have advised and consulted with us in the planning of projects and seminars.

In addition to our staff of seven, we have had a series of fine interns who have spent time assisting us in coordinating these efforts.

Center
for a New
Democracy

ANNUAL REPORT

1985-86

Founders
Gary Hart
Diane Meyer Simon
Herbert Simon
Tabitha King
Stephen King
Stuart Karl
Don W. Carlson
Don D. Montgomery, Jr
David Stein
William H. Watson
Ronald I. Dozoretz
Stewart Bainum, Jr
Micky Miller
John Barnes
Marilynn Gersten
Albert Gersten, Jr

Board of Directors
Gary Hart
Yvonne Braithwaite Burke
John Holum
Joel Hyatt
Rosabeth Moss Kanter
Regis McKenna
Don D. Montgomery, Jr
Raymond Orbach
Federico Pena
Robert B. Reich
Theodore C. Sorensen
Susan J. Williams

Council of Advisors
Roger C. Altman
Milner S. Ball
Kingman Brewster
James MacGregor Burns
Pat Choate
Edwin A. Deagle
Sidney D. Drell
Jack DuVall
Ralph Earle II, Esq
Carroll L. Estes
Shirley M. Hufstedler
Paul E. Peterson
Ronald K. Shelp
Larry K. Smith
Barry A. Stein
Lester C. Thurow
Laurence H. Tribe
Daniel Yankelovich

Executive Director
Martha Keys

220 I St., NE Suite 220
Washington, DC 20002
(202) 675-6050

Dear Friends,

When the Center for a New Democracy first moved into its offices a year ago today, we did not think it could move so quickly to establish itself as a source of bold, innovative solutions to the major challenges of our time.

A non-profit, non-partisan organization, the Center sponsored the widely noticed "New American Economy" seminar series that brought together a wide range of leading thinkers and doers to generate new answers to our economic problems. The Center also held a landmark conference on the future of the Pacific Rim, and is involving dozens of people in planning the nation's first electronic policy network. It has begun publishing quarterly New Realities as well as a series of seminar reports, and is developing an unusually successful membership program.

This is progress for one year. Speaking for the other Board members and myself, we are pleased with these accomplishments, and look forward to even greater successes in the year ahead.

Sincerely,

Gary Hart

Gary Hart
Chairman of the Board

May 1, 1986

Center
for a New
Democracy

Founders
Gary Hart
Diane Meyer Simon
Herbert Simon
Tabitha King
Stephen K
Stuart Karl
Don W. Carlson
Don D. Montgomery, Jr
David Simon
William H. Watson
Ronald I. Dozoretz
Stewart Bainum, Jr
Micky Miller
John Barnes
Marilynn Gersten
Albert Gersten, Jr

Board of Directors
Gary Hart
Yvonne Braithwaite Burke
John Holum
Joel Hyatt
Rosabeth Moss Kanter
Regis McKenna
Don D. Montgomery, Jr
Raymond Orbach
Federico Pena
Robert B. Reich
Theodore C. Sorensen
Susan J. Williams

Council of Advisors
Roger C. Altman
Milner S. Ball
Kingman Brewster
James MacGregor Burns
Pat Choate
Edwin A. Deagle
Sidney D. Drell
Jack DuVall
Ralph Earle II, Esq
Carroll L. Estes
Shirley M. Hufstedler
Paul E. Peterson
Ronald K. Shelp
Larry K. Smith
Barry A. Stein
Lester C. Thurow
Laurence H. Tribe
Daniel Yankelovich

Executive Director
Martha Keys

220 I St., NE Suite 220
Washington, DC 20002
(202) 675-6050

Dear Friends,

Our greatest accomplishment in the past year is the establishment of the Center for a New Democracy not as a Washington, D.C.-based think-tank, but as an interacting network of thinkers and doers from around the nation. Those who have been actively involved in the Center family and the policy-development process number far more than our Founders and Board of Directors and include:

- a Leadership Council of nearly 50
- a Membership Network of over 1000
- our Council of Advisors
- a growing group of people around the country who have volunteered time on Center projects and events
- the hundreds of people active in audience discussions
- the legion of private sector leaders, state and local government officials, academics and citizens who have advised and consulted with us in the planning of projects and seminars.

In addition to our staff of seven, we have had a series of fine interns who have spent time assisting us in coordinating these efforts.

We look forward to continued growth of our Center family enabling us to creatively and comprehensively continue to develop workable solutions to the dramatic new challenges facing Americans as we approach the last decade of this century and look toward a new one. Among the activities for our second year, we plan to:

- Finish our series of seminars on the NEW AMERICAN ECONOMY with a major conference and report summing up what we have learned from our first-year series of seminars around the nation.

- Begin a new series of seminars focusing on the NEW AMERICAN COMMUNITY which will highlight and learn from the key efforts being coordinated in American communities to address their problems and revitalize their area.

- Establish CENTERLINK, the nation's first electronic policy network that will give students, academics, journalists, policy professionals and other citizens access to basic information about the major policy initiatives of our time and the ability to participate in their development.

- Develop a STRATEGIC INVESTMENT INITIATIVE that will seek to highlight the key investments we as a nation must make in our people and our future to remain globally competitive.

- Co-sponsor with Inha University in Korea a followup conference on the Pacific Rim to be held in Seoul and to bring together multipartisan leaders from Pacific countries.

- Publish a major report on community service efforts around America.

In addition, we plan to continue the publication of our well-received mini-magazine NEW REALITIES on a quarterly basis, continue publishing reports on the key economic and social challenges and distributing them as widely as possible, begin a campaign to attract new members through a special newspaper advertisement and expand our direct mail program and membership network.

It is exciting and rewarding to be involved in this creative, partnership effort. We can only be successful as more join with us to give the best of their hearts, hands and pocketbooks to support this effort to mobilize the full range of American talents, resources, creativity, industry, and imagination and bring them to bear on the challenges at hand.

We invite you to become involved in this second year.

Sincerely,

Martha Keys

Martha Keys
Executive Director

May 1, 1986

FIRST YEAR PROJECTS

. . . SEMINARS AND CONFERENCES . . .

THE NEW AMERICAN ECONOMY SEMINAR SERIES

The Center for a New Democracy's economic seminar series, "The New American Economy: New Problems, New Approaches," was a major focus of the Center's first year of activity. Dealing with the challenges of trade, debt, modernization, the changing family's impact on the workplace, and displaced workers, the series was designed to highlight innovative solutions to the major macroeconomic and workplace challenges of our time.

I. BEYOND RECESSION: NEW PROBLEMS, NEW APPROACHES
Washington, DC – July 25, 1985.

This seminar marked the first major attempt to explore ways to prevent or weather what could be the first recession in post-war history to occur simultaneously with high budget deficits, which could limit the utility of traditional anti-recession "pump-priming" measures. It demonstrated that a consensus exists for bold new measures to revitalize America's economy.

Seminar participants included: **Pat Choate**, Senior Policy Analyst for Economics at **TRW**; **Robert Kuttner**, New Republic correspondent; U.S. Representative **Jim Jones**; **Hobart Rowen**, Columnist for the Washington Post **Howard Samuel**, President of the AFL-CIO's Industrial Union Department; U.S. Representative **Pat Schroeder**; **Alexander Trowbridge**, President of the National Association of Manufacturers; and **Martin Weitzman**, author of The Share Economy.

II. BEYOND PROTECTIONISM: NEW PROBLEMS, NEW APPROACHES
Atlanta, GA – November 23, 1985.

This second seminar demonstrated that a consensus exists for a comprehensive trade policy going beyond protectionism. It was co-sponsored by the Georgia International Business Center and the World Trade Club Atlanta.

Seminar participants included: **Ryan Amacher**, Dean of Clemson University's College of Commerce and Industry; Ambassador **Richard Gardner** of Columbia University; **Dennis Lockhart**, Vice President at Citicorp; **Stephen Marris**, Senior Fellow at the Institute for International Economics; **Richard Regan**, Partner at Booz-Allen & Hamilton; **Jack Sheehan**, Legislative Director for **the United Steelworkers; Ambassador Sally Shelton-Colby**, Vice President for Bankers Trust; **Lester Thurow**, author of The Zero-Sum Solution; and **Sidney Topol**, Chairman of the Board and CEO of Scientific Atlanta.

III. TOWARD SOLVENCY: NEW PROBLEMS, NEW APPROACHES

New York, NY - January 21, 1986.

This seminar looked at the interreaction of the high levels of debt of the international, Federal government, corporate, and consumer sectors and generated solutions for solving America's debt crisis. It was co-sponsored by the World Policy Institute, the Bildner Center for Western Hemispheric Studies at the City University of New York, and the Urban Research Center at New York University.

Seminar participants included: **Norman Bailey**, a former economic advisor to President Reagan; **Fred Bergsten**, Director of the Institute for International Economics; **Robert Bowman**, Treasurer of the State of Michigan; **Lawrence Chimerine**, Chairman and Chief Economist of Chase Econometrics; **John Forsgren**, Treasurer of the Sperry Corporation; **Mark Green**, President of the Democracy Project; **Ronald Hellman**, Professor of Sociology at the City University of New York; and **George Soros**, President of Soros Fund Management Company, Inc.

IV. MODERNIZING AMERICA: NEW PROBLEMS, NEW APPROACHES

Dallas, TX - January 27, 1986

The fourth seminar demonstrated the lessons America can learn from Texas's efforts to modernize, and was cosponsored by the Texas Alliance for the Next Economy (TEXANE) and Booz-Allen & Hamilton.

Seminar participants included: **John Brumley**, chair of the Texas Board of Education; **Max Faget**, President and CEO of Space Industries Inc.; **Gordon Foreward**, President and CEO of Chapparal Steel; Representative **Martin Frost**; **Edwin Harper**, President of Dallas Corp who served on President Reagan's Commission on Industrial Competitiveness; **Egil Juliussen**, President of Future Computing Inc.; **Rosabeth Moss Kanter**, President of Good Measure Inc.; **Ray Marshall**, former Secretary of Labor and now Professor at LBJ School; **William Moore**, President of Recognition Equipment Inc.; **W. Arthur Porter**, President of the Houston Area Research Consortium; **Vin Prothro**, President of **Dallas Biomedical Corp.**; **Palle Smidt**, Senior V.P. of Plans and Programs of the Microelectronics and Computer Consortium (MCC); **William Sommers**, Partner of Booz-Allen & Hamilton; and the **Del Tesar**, of the Robotics Institute at the University of Texas at Austin.

V. CHANGING FAMILY, CHANGING WORKPLACE: NEW PROBLEMS, NEW APPROACHES

Scheduled for Cleveland, OH - April 25, 1986

The Center also planned its fifth seminar, designed to explore new workplace policies needed as a result of the entry of women into the workforce and demographic shifts seeing more households headed by working parents, women and single parents. Cosponsors included 9to5 Working Women's Association and the Urban Affairs Department of Cleveland State University.

Planned participants included: **Janet Bullard**, Senior V.P. of Human Resources at Society National Bank; **Andrew Cherlin**, Professor of Sociology at John Hopkins University; **Judy Farrell**, Family Policy Panel Coordinator at the U.N. Association Economic Policy Council; **Douglas Henton**, Senior Policy Analyst at SRI International; **Joel Hyatt**, President of Hyatt Legal Services; **James Hyman**, Director of the Cleveland and Cuyahoga County's Private Industry Council; **Karen Nussbaum**, Director of 9to5; **Richard Shatten**, Executive Director of Cleveland Tomorrow; **Roberta Steinbacher**, Administrator of the Ohio Bureau of Employment Services; and **Nancy Tichy**, Employee Relations Counselor at the Cleveland Clinic Foundation.

VI. WORKERS IN TRANSITION: NEW PROBLEMS, NEW APPROACHES

Scheduled for Detroit, MI - May 19, 1986

The Center also planned the sixth seminar, designed to explore solutions to the problems of workers displaced by automation and international competition. The cosponsor was the Downriver Community Conference.

Scheduled participants included **Kathy Alessandro**, Director of Employment and Training at the Downriver Community Conference ; **Barry Bluestone**, author of The Deindustrialization of America; **Sheldon Friedman**, Director of Research of the United Autoworkers; **Julie Gorte**, Project Director of the Office of Technology Assessment's "Technology and Structural Unemployment" study; **Robert Lawrence**, Senior Fellow at the Brookings Institution; **Malcolm Lovell**, former Undersecretary of Labor under President Reagan; **Phillip Power**, Chairman of the Michigan Job-training Coordinating Council; **Ernest Savoie**, Director of Labor Relations Planning at Ford Motor Company; and **Thomas Turner**, President of the Metropolitan Detroit AFL-CIO.

VII. THE NEW AMERICAN ECONOMY

Tentatively scheduled for early 1987

The Center also began planning for a final conference designed to sum up the lessons of the previous six seminars. Scheduled for Washington, D.C., it will be a teleconference involving several other sites around the nation.

. . . INTERNATIONAL CONFERENCES . . .

The Center sponsored a major international conference in December 1985, TRANSITIONS IN THE PACIFIC RIM: LEADERSHIP FOR THE NEXT TWENTY YEARS, held in Laguna Niguel, California. The conference was co-sponsored by Harvard-East Asia, the Monarch Beach Institute, UCLA and United Airlines.

The conference brought together more than 40 multi-partisan Pacific Rim leaders and featured speeches by Senator Gary Hart, the Chinese Ambassador to the United States, Han Xu, and Richard Holbrooke. Participants, including the Deputy Prime Minister of Malaysia, four Cabinet officials, 22 Members of Parliament, the Liberal Party Opposition leader from Canada, and six members of the U.S. Congress, held four sessions on economics and politics.

The Center is planning to assist Inha University of Korea in holding a second conference in December 1986. It has also initiated discussions on a possible conference of Latin American leaders.

. . .THE NEW AMERICAN COMMUNITY SEMINAR SERIES . . .

During 1985-6, the Center also began planning for a series of seminars focusing on THE NEW AMERICAN COMMUNITY.

This seminar series is designed to identify strategic domestic investments and learn from the key efforts being successfully coordinated in American communities to address their problems and revitalize their areas.

Each session will feature a mix of national experts who understand America's changing society and local doers who have developed initiatives to respond to such changes. The series will 1) identify the changes in the family, workforce, and general population which will require new policies; and 2) identify initiatives in states and cities around America that respond to such societal changes effectively - initiatives that encourage self-reliance and growth, are cost-effective and enjoy broad public support; and 3) publish a series of reports on these initiatives and their implications for national policy change.

. . . SPECIAL PROJECTS . . .

I. CENTERLINK

The Center devoted extensive effort in 1985-6 to laying the basis for "CenterLink", designed to be the nation's first electronic policy network.

This project is designed to provide basic information about several dozen of the major policy initiatives of our time, from reducing the budget deficit to improving U.S.-Soviet relations to ending world hunger.

The Center began to prepare Policy Resource Outlines (PROs) on each policy initiative. Each PRO provides a basic overview of the initiative, proposed solutions to achieve the initiative, and a list of key documents, organizations and experts working on it. Each PRO is designed to be an objective and comprehensive overview of policy initiatives and is to be further developed by activists around the country.

The Center plans to make these PROs available to its members and interested citizens either through the mails or through its electronic network, CenterLink.

In addition to serving as a policy database, CenterLink is also being designed to provide facilities for electronic conferences on selected topics, for citizen sharing about experiences in working on various policy initiatives.

Most importantly, CenterLink is designed as a two-way communications network, whereby participants can help advise the Center on projects ranging from its New American Community seminar series to the contents of the PROs themselves.

II. THE STRATEGIC INVESTMENT INITIATIVE

During 1985-6, the Center began work on developing a "Strategic Investment Initiative" that will identify the key investments the United States must make over the next five years to regain its international competitiveness and remain a leading economic power.

The initiative is based on the premise that the United States cannot afford everything, and must carefully select those key investments necessary to guarantee economic strength by laying the foundation for growth in a post-industrial world economy.

It will detail critical investments needed in education, research and development, job-training, commercialization of new technologies, export incentives and rebuilding the old and creating the new infrastructure of an increasingly information-oriented economy.

The initiative recognizes the seriousness of the budget deficits, and seeks to fund needed investments through program transfers, off-budget mechanisms, and, where needed, revenue increases tied to specific investments.

The Center intends to develop this proposal through wide consultation with expert, doers, and organizations around the country.

III. NATIONAL SERVICE

The Center hired a consultant to investigate the history, ethos, current status, costs and benefits, and future prospects of national service. The Center also began to seek support to underwrite the on-site research and writing of a major publication that would, in readable language and attractive format, provide a comprehensive survey of the grassroots support for the idea of national service. The publication would also, for the first time, present at comprehensive look at the rapidly multiplying community service efforts around America.

. . . PUBLICATIONS . . .

I. NEW REALITIES

The Center began its quarterly publication, New Realities in the first quarter of 1986. Featuring original articles by leading-edge thinkers around the nation, each mini-magazine is arranged around a theme. The first issue dealt with America's emergent economy, and featured pieces by industrialist, Sidney Harmon, and SRI analyst Douglas Henton, and an interview with Joel Hyatt of Hyatt Legal Services.

II. OTHER PUBLICATIONS

The Center also laid the basis in 1985-6 for several series of publications:

o Transcripts - The Center made available to members and interested citizens transcripts of its recession, trade and solvency seminars as published in The World Policy Journal

o Reports - The Center began a series of reports based on its seminars and conferences. These include VOICES FROM THE PACIFIC RIM, based on its Pacific Rim conference; FIX THE ROOF WHILE THE SUN IS SHINING, based on its solvency seminar; TRADE STRENGTH BEGINS AT HOME, based on its trade seminar.

o Policy Resource Outlines - The Center published its first Policy Resource Outline in 1985-6, entitled "Reducing the Deficit".

THE CENTER FOR A NEW DEMOCRACY
Balance Sheet
March 31, 1986

ASSETS	
Current Assets:	
Cash	$ 34,105
Other	1,025
Total Current Assets	35,130
Property and equipment, at cost:	
Office furniture and equipment	12,843
Computer equipment	6,478
Equipment under capital lease	6,513
	25,834
Less - accumulated depreciation	4,494
Net property and equipment	21,340
Other	7,482
Total Assets	$ 63,952
LIABILITIES AND CENTER EQUITY	
Current liabilities:	
Accounts payable and accrued expenses	16,354
Obligation under capital lease	2,130
Current portion of long-term debt	1,275
Total Current Liabilities	19,759
Noncurrent capital lease obligation	2,471
Long-term debt	1,886
Total Liabilities	24,116
Center Equity	39,836
Total Liabilities and Center Equity	$ 63,952

THE CENTER FOR A NEW DEMOCRACY
STATEMENT OF REVENUES, EXPENSES AND CENTER EQUITY
From Date Of Inception to March 31, 1986

Revenues:	
Membership and contributions	$ 491,592
Interest income	2,598
Costs and expenses:	
Salaries and related costs	169,710
Consulting	7,000
Rent and Utilities	29,590
Center seminars and participant travel	121,186
Telemarketing	18,569
Direct mail	46,718
Meetings and staff travel	13,744
Telephone	14,196
Depreciation	4,494
Printing and reproduction	6,891
Postage	6,440
Office supplies	9,120
Interest	1,172
Legal fees	1,870
Other	3,654
	454,354
Revenues in excess of expenses	39,836
Center equity, beginning of year	
Center equity, end of year	39,836

THE CENTER FOR A NEW DEMOCRACY
STATEMENT OF CHANGES IN FINANCIAL POSITION
From the Date of Inception to March 31, 1986

Source:	
Excess of revenues over expenses	$ 39,836
Charges to income not nvolving the use of working capital:	
Depreciation	4,494
Working capital provided by operations	44,330
Long-term portion of capital lease obligation	2,471
Long-term debt	1,886
	48,687
Application:	
Acquisition of property and equipment	25,834
Other	7,482
	33,316
Working Capital	$ 15,371
Components of Working Capital:	
Current assets:	
Cash	$ 34,105
Other	1,025
	35,130
Current Liabilities:	
Accounts payable and accrued expenses	16,354
Obligation under capital lease	2,130
Current portion of long-term debt	1,275
	19,759
Working Capital	$ 15,371

THE CENTER FOR A NEW DEMOCRACY
NOTES TO FINANCIAL STATEMENTS
March 31, 1986

1. SIGNIFICANT ACCOUNTING POLICIES

Contributions -- Income from contributions is recognized in the year in which the contribution is received.

DEPRECIATION -- Depreciation of property and equipment is determined on the straight-line bases, over estimated useful lives of five years. Equipment leased under a capital lease is depreciated over the term of the lease or the estimated useful life of the equipment, whichever is lower.

INCOME TAX STATUS -- The Center is exempt from Federal income tax under 501 (c) (3) of the Internal Revenue Code.

2. COMMITMENTS

The Center is obligated for office space under the provisions of a lease as follows:

1986---------	$ 19,956
1987---------	$ 27,517
1988---------	$ 9,324.08

The lease provides for rent increases in an amount equal to 9.93% of the increase to the lessor's real estate tax, over certain base real estate tax amounts.

The Center leases certain equipment under the provisions of a capital lease. The future minimum payments under this lease at March 31, 1986 are as follows:

1986---------	$ 1,784
1987---------	$ 2,676
1988---------	$ 892
	$ 5,352
Less interest	$ 751
Present value of minimum lease payments	$ 4,601

The Center for a New Democracy expresses appreciation and gratitude to those who have joined with us and provided the financial support for this first year.

FOUNDERS ($25,000 OR MORE)

Stewart Bainum
John Barnes
Don Carlson
Stephen and Tabitha King
Diane and Herbert Simon
Steve Wozniak

SPONSORS ($10,000 -$25,000)

Richard Dennis
Stuart Karl
Peter and Judy Kovler
Don Montgomery
Rockefeller Foundation *
Harvard-East Asia Center *

CONTRIBUTORS ($1,000-10,000

American Express *
Amoco Corporation *
Bank of America *
Baskerville-Donovan
Bechtel Power *
Bell & Howell *
Berman for Congress
Michael A. Block
Boeing Aerospace/Vertol *
Chonbang Co. *
Dae Woo *
Dainong *
Dick Leonard Group
Douglas Aircraft *
Duncan, Inc. (Fred Levin)
Far East Economic Review *
Food Marketing Dev. *
Fung Ping Fan
Gould Inc. *
Hemmer & Yates
Joel Hyatt
Intel *
Korean Air *
Lucky Gold Star *
Regis McKenna
Mitsubishi *

Motion Picture Export *
National Westminster Bank *
Nike *
Nippon Steel *
Nissan Motor Corp *
PPG Industries *
PACCAR Int'l *
Pacific Telesis *
Phillip Morris Int'l. *
Pillsbury Madison Sutro *
Republic National Bank *
Shin Kong Life Insurance *
Shu-Kwang Corp. *
Sime Darby *
South Sea Textile *
Sumitomo Electric *
Pillsbury Co. *
Traweek Investment *
Toyota *
Xerox *

LEADERSHIP COUNCIL — MEMBERSHIP NETWORK ($1,000-3,000)

Gary Antonoff
Thomas Bily
E.W. Bisett
Adam Borison
Bill Bradley
Anne. W. Branscomb
Richard Roby & Jeanne Busch
Trudy Chang
Leila Cofield
R. Ken Coit
Richard Crowther
J. Paul Dawson
Alan Eaton
Mr. & Mrs. Fitzgerald
James Fousekis
Anna Hurd
Perry Herst, Jr.
Mr. & Mrs. Johnson
Dr. Rosabeth Moss Kanter
Phyllis Katz
John Koskinen
Ken & Derril Kripke
Kathy & Red Lambeth
Bradford Kirkman-Liff
Harold Lincoln
Mr. & Mrs. Hal Linden
Paul Lurie
Winthrop McCormack

William McNamee, Sr.
Alan Minier
Dennis Opsahl
Joel Picker
Dr. Spencer and Beverly Pugh
Howard Ragsdale
George Reese
Alan Shapley
Donald Shaw
Evelyn Stout
Eddie Tabash
Mr. & Mrs. Tawill
Mr. & Mrs. Torgove
George M. Wallace
Vince Whibbs

SUSTAINERS ($200-1000)

Morley Ballantine
Marguerite Blanke
Lelyn Braun
Edward Broderick
Franklin & Anne Carter
Bruce Christensen
Charlotte Conway
Paul Dean
William Delano
L.W. Erickson
Yvonne Esposito
Charles Faddis
J.M. and Elizabeth Gitt
Rachel Goetz
Robert Golden
Neal Goodman
Barbara Gross
Tom Grow
Anne Hansen
Barbara Hargove
Jane & Pharis Harvey
Ray Hatler
Cynthia Hewitt
John Hobbs
Melvin Honowitz
Otis Kinkade
Matthew Malow
Saul Olzman
Albert and Miriam Ornstein
Charles Riggs
Stanton Rosenbaum
Myrtle Ross

S.L. Schorr
L.E. Stringer
Charles Stromberg
Alfred Van Huyck
William Watson
George Weathers
Edward Wortman
Charlotte Yarborough
Faith Young

NATIONAL MEMBERSHIP NETWORK ($20-199)

959 members

* signifies contribution supporting the "Transitions in the Pacific Rim" conference, held December 5-8, 1985.

Annual Report Addendum: April 1, 1986 to present

FOUNDERS ($25,000 OR MORE)

Don Montgomery
Albert & Marilynn Gersten

SPONSORS ($10,000-$25,000)

ARCA Foundation
Tides Foundation

LEADERSHIP COUNCIL — MEMBERSHIP NETWORK ($1,000-3,000)

Rena Rowan
Leonard Robinson
Will Cheek
Joseph Crowley
Lisa Lindelef
Lloyd S. Gilmour
Dr. Jeanne and Mr. Robert Segal
Richard Goldman
Kathryn Partridge
Barbara Dixon
Gregory Hahn
Alan Shapley
Arvin Upton

SUSTAINERS ($200-1000)

Joan Silberman
Kenneth Rowe
Donald & Nancy Myhre
John Butler
Ray Farabee
Ruth Watkins
Martha Tolman
Patrick Welch
Richard Webb
Thomas Congdon
Ulrich Ernst
Edward Ramey
Jessie Madison
Donald & Beverly Haynes
George Strong
Joseph Brophy
Alice Mahoney
Norma Gannon
Sydney Pollack
Alice Rothchild

NATIONAL MEMBERSHIP NETWORK ($20-199)

1202 members

Mr. **Flippo**. Thank you very much.

Mr. Wallace, I believe you might have been a little late coming in, we would like for you—we will include your entire statement in the record, and we would appreciate your summarizing your statement, and we're pleased to have you.

STATEMENT OF JOHN R. WALLACE, COUNSEL, NORTH CAROLINA DEMOCRATIC PARTY

Mr. **Wallace**. Thank you, Mr. Chairman. I appreciate the opportunity to address the committee with regard to the political activities of tax-exempt organizations and the abuse of the privilege of tax-exempt status by certain entities operating in the political arena in North Carolina.

These organizations that I speak of are affiliated with the National Congressional Club of Senator Jesse Helms. They include the Educational Support Foundation, 501(c)(4), the Coalition for Freedom, a 501(c)(3), and the Congressional Club Foundation, a 501(c)(4).

My remarks will focus on these three tax-exempt entities because they are and remain actively involved in the efforts of the National Congressional Club, and have a pernicious influence on the political process in North Carolina.

The Educational Support Foundation is the sole shareholder of Jefferson Marketing, which is the marketing arm of the National Congressional Club. The Congressional Club Foundation was formed by club officials as a tax-exempt lobbying organization. The Coalition for Freedom was formed by club officials as a mechanism for the propagation of political agenda of the Congressional Club.

Following the election of Senator Helms in November of 1972, two associates of Senator Helms, Mr. Tom Ellis, a Raleigh lawyer, and Mr. Carter Wrenn, a North Carolina political operative, formed the North Carolina Congressional Club to retire the Helms Committee debt. Senator Helms was reelected in 1978 through the efforts of the Helms for Senate Committee and the North Carolina Congressional Club. Thereafter, the North Carolina Congressional Club changed its name, becoming the National Congressional Club, and undertook political efforts national in scope.

Senator Helms has extensive relationships with the club and has acted as its honorary chairman for the period 1973 to 1983, at which time he resigned, becoming at that time a candidate for reelection to the U.S. Senate.

The treasurer of the National Congressional Club is Mr. Wrenn, and the chairman of the National Congressional Club is Mr. Ellis.

Jefferson Marketing was organized as a for-profit corporation by Mr. Wrenn and others in 1979. At that time direct mail operations of the National Congressional Club were spun off. Certain employees left the staff of the club, joining the staff of Jefferson Marketing, and it commenced its for-profit political activities. At the time of its formation, shares in Jefferson Marketing were owned by a single individual, and were thereafter acquired by another, Mr. Richard A. Miller, a former chairman of the National Congressional Club.

In 1981, the Congressional Club Foundation, a 501(c)(4), was formed under the laws of the State of North Carolina, and acquired ownership of all of the stock of Jefferson Marketing.

Thereafter, in 1983, the Educational Support Foundation, another 501(c)(4), acquired from the Congressional Club Foundation the capital stock of Jefferson Marketing. Both the Congressional Club Foundation and the Educational Support Foundation were formed by Mr. Wrenn and Mr. Ellis, and operate out of the offices shared by the National Congressional Club and Jefferson Marketing, Inc.

Mr. Wrenn and Mr. Ellis have continued to operate the Congressional Club, Jefferson Marketing, the Educational Support Foundation, owner of Jefferson Marketing, the Congressional Club Foundation, and the Coalition for Freedom.

The Coalition for Freedom has been the most active publicly of these tax-exempt organizations. Mr. Wrenn said at one time that the coalition was set up to get a conservative message out to the media.

In 1983 the coalition raised in excess of $750,000, and expended in excess of $300,000 in its advertising and mailing program. This, of course, was the year prior to the November 1984 general election in which Senator Helms was a candidate. These efforts by Mr. Wrenn and Mr. Ellis, through the coalition, advanced the Helms philosophy and agenda.

It is my belief that these expenditures were part of the club's preparation for the 1984 Helms campaign.

In 1984, coincident with the Helms campaign, the coalition raised in excess of $870,000, and paid salaries of $123,000, expending in excess of $100,000 for television production and air time.

In 1985, the Coalition for Freedom raised in excess of $750,000, employing only one person, Mr. Wrenn, at a salary of some $40,000. Of course, during 1985, Mr. Wrenn continued to direct the National Congressional Club, as well as Jefferson Marketing, again out of the same offices, receiving in excess of $58,000 in consulting fees from the Congressional Club.

As a result of complaints filed with the Federal Election Commission against Jefferson Marketing and the National Congressional Club, the general counsel of the Federal Election Commission determined that by virtue of the fact that those organizations were directed by Mr. Wrenn and Mr. Ellis, general counsel concluded that they are and were one and the same. Counsel concluded that the commercial ventures between Jefferson Marketing and the National Congressional Club were not arm's-length, and amounted to self-dealing.

In the course of that litigation, a consent decree was entered in Federal Court in the Eastern District of North Carolina by which it was admitted that Jefferson Marketing and the club were in fact one and the same.

It is my belief that this network of affiliated organizations centered around the club exists to promote and advance the political career and philosophy of Senator Helms and, incidentally, those candidates whom he favors.

This organization, this network, has been established and designed, and implemented with the intent of evading the Federal

Election Campaign Act and the Internal Revenue Code to achieve those desired ends. By the formation of these tax-exempt organizations, several parts of the design have been accomplished.

First, in the case of the Coalition for Freedom, the club has operated a tax-exempt vehicle for the development of a donor base for the benefit of Senator Helms and selected candidates. This has been done at the expense of a tax-exempt organization, and not at the expense of Helms' own political committee, or at the expense of the club.

Second, in years in which Senator Helms has not been a candidate, the direct mail campaign has kept his name before potential contributors to his campaign, and has enabled his organization to keep current a political mailing list maintained by the Congressional Club and Jefferson Marketing.

Third, the activities of the Coalition for Freedom have enabled the club to keep significant revenues flowing for the benefit of Jefferson Marketing in nonelection years.

Fourth, the operations of the coalition have enabled the club to pay the salaries of political operatives in campaigns and in nonelection years.

Finally, the club has operated the coalition as a tax-exempt vehicle to propagate its message in the media.

This network of political organizations is and has been operated as one organization for the benefit of Senator Helms. It is in fact a political shell game through which the funds, resources, personnel are moved to best suit the interests of the club and Senator Helms.

The FEC has engaged in extensive expensive litigation with the club and Jefferson Marketing, and in essence has reached these same conclusions with regard to the club and Jefferson Marketing:

There are limits to the jurisdiction of the Federal Election Commission and practical limits on the commission's enforcement capabilities, resulting in its inability to address the activities of the 501(c)(3) and (c)(4) organizations that I have spoken of.

An examination of these organizations and their affiliations demonstrates the need for closer scrutiny under existing law or perhaps the need for legislative change to address the present political environment.

Mr. **Flippo**. Thank you, Mr. Wallace.

[The prepared statement follows:]

TESTIMONY OF JOHN R. WALLACE, COUNSEL
NORTH CAROLINA DEMOCRATIC PARTY

HOUSE WAYS AND MEANS OVERSIGHT SUBCOMMITTEE
MARCH 13, 1987

Mr. Chairman, Members of the Subcommittee, I appreciate the opportunity to address the Committee with regard to the political activities of tax-exempt organizations and the abuse of the privilege of tax-exempt status by certain entities operating in the political arena in North Carolina. These organizations that I speak of are affiliated with the National Congressional Club of Senator Jesse Helms. They include the Educational Support Foundation, a §501(c)(4); the Coalition for Freedom, a §501(c)(3); and the Congressional Club Foundation, a §501(c)(4). Other organizations connected with Senator Helms and his staff including the American Family Institute, Centre For a Free Society, the Institute of Money and Inflation, and the Institute of American Relations, have been the subject of a prior investigation by the late Representative Benjamin Rosenthal.

My remarks will focus on three tax-exempt entities, the Coalition for Freedom, the Educational Support Foundation, and the Congressional Club Foundation, because they are and remain actively involved in the efforts of the National Congressional Club (NCC) and thus have a pernicious influence on the political process in North Carolina. The Educational Support Foundation, Inc. is the sole shareholder of Jefferson Marketing, Inc. (JMI), the marketing arm of the National Congressional Club. The Congressional Club Foundation was formed by Club officials as a tax-exempt lobbying organization. The Coalition for Freedom was formed by Club officials as a mechanism for the propagation of the political agenda of the Club. A brief review of the history of these organizations is appropriate.

The National Congressional Club and Jefferson Marketing, Inc.

Following the election of Senator Helms in November of 1972, two associates of Senator Helms, Thomas F. Ellis, a Raleigh lawyer, and R. E. Carter Wrenn, a North Carolina political operative, formed the North Carolina Congressional Club to retire the Helms Committee debt. The Committee was registered as a single candidate committee affiliated with the Helms for United States Senate Committee on December 11, 1973. On November 7, 1974, the North Carolina Congressional Club changed its status from a single candidate committee to a multi-candidate committee and thereafter in 1975, qualified as a multi-candidate committee.

In 1976 Senator Helms authorized the Helms for Senate Committee to serve as his principle campaign committee for the 1978 election cycle. In 1977, the North Carolina Congressional Club notified the Federal Election Commission that it was resigning its status as a multi-candidate committee and becoming, again, a single candidate committee affiliated with the Helms for Senate Committee. The Federal Election Commission, in 1978, found that the North Carolina Congressional Club had violated the Federal Election Campaign Act upon its reaffiliation with the Helms for Senate Committee. (MUR 459, Federal Election Commission)

Senator Helms was reelected through the efforts of the Helms for Senate Committee and the North Carolina Congressional Club in the general election in 1978.

Thereafter, in 1979, the North Carolina Congressional Club changed its name to the National Congressional Club and again became a multi-candidate committee.

Senator Helms has extensive relationships with the Club and acted as its Honorary Chairman for the period 1973 to 1983. The Treasurer of the National Congressional Club is Mr. Wrenn. The Chairman of the National Congressional Club is Mr. Ellis.

In 1979, Jefferson Marketing, Inc. was organized under the laws of North Carolina as a for-profit corporation by Mr. Wrenn and others. At that time, the National Congressional Club was conducting its own direct mail advertising, but upon the formation of Jefferson Marketing, Inc., the direct mail operation of the National Congressional Club and 32 of the original 53 employees hired to work for Jefferson Marketing, Inc. were transferred from the National Congressional Club to JMI. At the time of the formation, Mr. Wrenn was hired by Jefferson Marketing, Inc. and was seated on its board of directors.

Mr. Wrenn and others associated with the National Congressional Club were instrumental in bringing JMI into being. Mr. Wrenn has been the overseer of the development of JMI through intervention on behalf of the National Congressional Club, the largest client of Jefferson Marketing, Inc. Jefferson Marketing, Inc. has shared the same offices and the same building with the National Congressional Club since the beginning of its existence in 1979.

At the time of its formation in 1979, the shares of Jefferson Marketing, Inc. were owned by a single individual and thereafter, were acquired by another individual, Richard W. Miller, former chairman of the National Congressional Club. In 1981, the Congressional Club Foundation, Inc. was formed as a non-profit corporation under the laws of the State of North Carolina and acquired ownership of all of the stock of Jefferson Marketing, Inc.

The Congressional Club Foundation, Inc. was organized purportedly for the promotion of social welfare within the meaning of §501(c)(4) of the Internal Revenue Code. In 1983, the Educational Support Foundation, Inc. was formed under the laws of the State of North Carolina also purportedly for the promotion of social welfare as a 501(c)(4) organization.

In 1983, the Educational Support Foundation, Inc. acquired all the outstanding shares of capital stock of Jefferson Marketing, Inc. from the Congressional Club Foundation, Inc. Both the Congressional Club Foundation, Inc. and the Educational Support Foundation, Inc. were formed by Mr. Wrenn and Mr. Ellis and operate out of the offices of the National Congressional Club and Jefferson Marketing, Inc.

From 1981 to the present, the control of JMI's board of directors has been vested in the board of directors of the Congressional Club Foundation, Inc., and subsequently the Educational Support Foundation, Inc. Both of these foundations have been under the direction of Mr. Wrenn by himself or with Mr. Ellis, the two officers of the National Congressional Club. Under the corporate charter of Jefferson Marketing, Inc., Mr. Wrenn and Mr. Ellis have complete and total control of the composition of the board of directors of Jefferson Marketing, Inc. Thus, Mr. Wrenn and Mr. Ellis, the managing officials of the National Congressional Club, retained ultimate control over the financial as well as the general management of Jefferson Marketing, Inc.

During 1982, the National Congressional Club and Jefferson Marketing, Inc. implemented an arrangement for the use of all JMI employees for the Club's efforts. To the extent that employees of Jefferson Marketing, Inc. were not required for the projects of the National Congressional Club, they were to provide in-kind services to candidates selected and promoted by the Club. At that time, the National Congressional Club was paying for all of

JMI's salaries, overhead, profit, and expenses, including the outlays for capital equipment.

In 1982, the practices of the National Congressional Club and Jefferson Marketing, Inc. resulted in a complaint filed with the Federal Election Commission by Congressman Charles G. Rose of the Seventh District of North Carolina. The Federal Election Commission investigated and prosecuted the complaint. (MUR 1503) A Consent Decree between Jefferson Marketing, Inc., the National Congressional Club and the Federal Election Commission was ultimately filed in the U.S. District Court for the Eastern District of North Carolina on May 6, 1986. In addition to substantial civil penalties, Jefferson Marketing, Inc. and the National Congressional Club admitted that they had operated as one entity through 1982. The Consent Decree prohibited further service by Wrenn and Ellis on the board of the Educational Support Foundation, Inc. and, among other things, required reporting by Jefferson Marketing, Inc. to the Federal Election Commission of its activities through mid-1986.

In the 1984 general election, the National Congressional Club and Jefferson Marketing, Inc. were integrated with the operation of the Helms for Senate Committee. The chairman of the North Carolina Democratic Party, now Congressman David E. Price of the Fourth District of North Carolina, alleged by complaint to the Federal Election Commission further violations of the FECA. That complaint resulted in a Conciliation Agreement in MUR 1792 between the Helms Committee, the National Congressional Club, Jefferson Marketing, Inc. and the Federal Election Commission by which the National Congressional Club, and Helms Committee along with Jefferson Marketing, Inc. admitted further violations of the Federal Election Campaign Act and paid additional civil penalties.

The Role of Tax-Exempt Organizations

Since their formation, the Congressional Club Foundation, Inc., Educational Support Foundation, Inc. and the Coalition for Freedom, Inc. have been central to the existence and advancement of the goals and policies of the National Congressional Club and an integral part of the operational entity, Jefferson Marketing, Inc. The Educational Support Foundation, Inc. constitutes a holding company by which Mr. Wrenn and Mr. Ellis have controlled and directed Jefferson Marketing, Inc. to benefit the political interests of the National Congressional Club. The Congressional Club Foundation, Inc. has engaged in direct mail fundraising, a part of the overall Jefferson Marketing, Inc. prospecting done for the candidates of the Congressional Club, and has paid Mr. Wrenn, in 1985, a salary of $3,400.00.

The Coalition for Freedom, Inc. has been the most active of these tax-exempt organizations. Mr. Wrenn has said that the Coalition was set up to "get a conservative message out through the media". (Congressional Quarterly, March 6, 1982, p. 503.)

In 1983, the Coalition raised in excess of $750,000.00 and expended in excess of $300,000.00 in its advertising and mailing program. These efforts directed by Mr. Wrenn and Mr. Ellis, advanced the Helms philosphy and agenda. It is my belief that such expenditures were part of the Club's preparation for the 1984 Helms campaign. In 1983, the Coalition incurred approximately $80,000.00 in expenses for travel and entertainment. It employed three persons with salaries averaging $40,000.00 each, including Terry Edmondson, a former Congressional Club staffer, and John King who managed the 1984 campaign for Congressman Bill Cobey elected from the Fourth District of North Carolina, defeating Congressman Ike Andrews. Mr. Cobey was a 1980 Congressional Club-backed candidate for Lt. Governor of North Carolina and in 1982 was the Congressional Club backed candidate for the Fourth Congressional District from North Carolina. Subsequent to his 1982 defeat, Mr. Cobey was employed by the Taxpayers Educational Foundation, another tax-exempt Congressional Club offshoot, pending his 1984 campaign for Congress.

In 1984, coincident with the Helms campaign, the Coalition for Freedom, Inc. raised in excess of $870,000.00, paid salaries of $123,770.00 and expended in excess of $100,000.00 for television production and air time.

In 1985, the Coalition for Freedom, Inc. raised in excess of $750,000.00, but employed only one person, Mr. Wrenn, at a salary of $40,540.00. Of course, Mr. Wrenn continued during 1985 to direct the National Congressional Club as well as Jefferson Marketing, Inc., receiving in excess of $58,000.00 in consulting fees from the National Congressional Club. In 1985 alone, the Coalition for Freedom expended $67,000.00 for travel and in excess of $300,000.00 for fundraising and media. For its program services, expenditures were made in amounts of approximately $70,000.00 on behalf of Roosevelt Grier's §501(c)(3) project, *Are You Committed?*. Mr. Grier had, during 1984, campaigned on behalf of Senator Jesse Helms' reelection. The Coalition also expended in excess of $30,000.00 in 1985 to produce a 30-minute documentary film entitled "Bias in Media", coincident with the now infamous attempt by Senator Helms and his associates to take over CBS through the Club-related vehicle, Fairness In Media.

The affiliation between the Coalition for Freedom and Jefferson Marketing, Inc. is demonstrated in the 1983 and 1985 Form 990 returns of the Coalition for Freedom, Inc. which show that in December, 1983, the Coalition for Freedom, Inc. received as a donation a computer with a value of $90,000.00 from one of its affiliated organizations, only one of which, Jefferson Marketing, Inc., is a for-profit corporation. The Coalition then resold the computer in a purchase money transaction to Jefferson Marketing, Inc. The 1985 Form 990 return of the Coalition for Freedom, Inc. demonstrates that Jefferson Marketing, Inc., the likely donor and beneficiary of a charitable deduction in 1983 has not kept the installments and the obligation it has to the Coalition for Freedom, Inc. current.

Common Control and Private Inurement

The General Counsel of the Federal Election Commission in MUR 1503 concluded "there is ample evidence that NCC, both directly and indirectly, exerts a dominating control over the financing of JMI. From 1981 to the present the JMI board of directors has been under the control of one of two successive sole shareholders, the Congressional Club Foundation, Inc. and the Educational Support Foundation, Inc., both of whose board of directors are controlled by either Mr. Wrenn alone or by Mr. Wrenn and Mr. Ellis, the governing officials of NCC."

The General Counsel further concluded that "for purposes of the FECA, JMI and NCC are one and the same. In operation, there is little practical distinction between the two. Commercial ventures between JMI and NCC are not at arms length and amount to self-dealing by NCC. The JMI/NCC combination permits the transfer of contributed funds to corporation to serve the needs of a political committee thereby defeating important statutory purposes. The JMI/NCC combination circumvents reporting requirements, the prohibition of corporate contributions to political committees and contribution limitations -- all integral to the statutory scheme of the FECA." Under these circumstances, the General Counsel advised the Commission may disregard the corporate entity of JMI and pierce the corporate veil in treating JMI and NCC as one organization. (General Counsel's Brief, MUR 1503, July 31, 1984)

It is my belief that the complex network of affiliated organizations centered around the National Congressional Club exists to promote and advance the political career and philosophy of Senator Jesse Helms and, incidentally, those candidates that he favors. The network has been established, designed and implemented with the intention of purposefully evading the Federal Election Campaign Act and the Internal Revenue Code to achieve desired ends. By the formation of tax-exempt organizations, several parts of the design have been accomplished. First, in the case of the Coalition for Freedom, Inc., the Club operates a tax-exempt vehicle for the development of a donor base for the benefit of Helms and selected candidates. This is done at the expense of a tax-exempt organization and not at the expense of Helms' own political committee or at the expense of the Club. Second, in years in which Senator Helms is not a candidate, the direct mail program of the Coalition for Freedom, Inc. keeps his name before potential contributors to his campaign and enables his organizations to keep the political mailing list current, a significant benefit. Third, the activities of the Coalition for Freedom, Inc. enable the Club to keep significant revenues flowing for the benefit of Jefferson Marketing, Inc. in non-election years. Fourth, the operations of the Coalition for Freedom, Inc. have enabled the Club to pay the salaries of political operatives in campaigns and in non-election years. Fifth, the Club operates the Coalition as a tax-exempt vehicle to propagate its message in the media.

The operation of the Congressional Club Foundation, Inc. has served as a means of maintaining ownership of Jefferson Marketing, Inc., now undertaken by the Educational Support Foundation, Inc., and as a means of conducting lobbying activity in behalf of the Club in order to promote the Club's agenda.

This network of organizations is operated and has been operated as one organization for the benefit of Senator Helms. It is in fact, a political shell game through which funds, resources, and personnel are moved to best suit the interests of the National Congressional Club and its principal constituent, Senator Helms, in furtherance of his political goals and political philosophy.

The FEC has engaged in extensive and expensive litigation with the Club and, in essence, has reached these conclusions. However, there are limits to Federal Election Commission's jurisdiction and practical limits on the Federal Election Commission's ability to address the activities of the §501(c)(3) and §501(c)(4) organizations of which I have spoken. The Federal Election Commission has not and will not likely investigate the activities of the Coalition for Freedom, Inc., the Educational Support Foundation, Inc., or the Congressional Club Foundation, Inc. Yet they are an integral part of the operations of the National Congressional Club. Apparently, no scrutiny of these organizations has been undertaken by the Internal Revenue Service. These organizations must be examined in the context in which they operate for it is apparent that their operation does not promote the social welfare, but instead promotes the political philosophy and interests of Senator Helms, Mr. Ellis and Mr. Wrenn in apparent violation of the Internal Revenue Code. An examination of these organizations and their affiliations demonstrates the need for closer scrutiny under existing law or perhaps the need for legislative changes to address the present political environment.

Thank you again for the opportunity to appear before you today. If I may be of further assistance to you with respect to any questions that you may have, I am ready to assist you.

* * *

[Ed. Note.—Supporting documents submitted with this statement have been retained in the subcommittee files.]

Mr. FLIPPO. Mr. Wallace, your testimony indicates your concern about the use of related or in-tandem type organizations. Would you care to comment on where the tax law falls short in this area, or where the FEC falls short in this area, or what about State laws in this area?

Mr. WALLACE. I have less concern about the tax law falling short than I have concern about the inability of the Service to actually enforce the existing law.

However, it strikes me that the type of affiliation that we have experienced in North Carolina between multicandidate political committees, for-profit political marketing vehicles, and not-for-profit 501(c)(3) and (c)(4) organizations is perhaps too close, and perhaps there ought to be legislation to address that close affiliation, to prevent that sort of close affiliation.

It strikes me further that the Federal Election Commission is perhaps without sufficient resources to address these problems. It occurs to me that the Coalition for Freedom might properly be attacked as a political committee. But again, the practical limits of the FEC's enforcement capabilities perhaps have been reached.

Mr. FLIPPO. Well, I might note for the record that since you mentioned Senator Helms' committees, that the subcommittee staff has invited or did invite groups associated with Senator Helms to testify today, and we were unable to arrange that. We have not had a response from them, just for the record.

Let me ask Ms. Keys, I know you have discussed the disclosure and that your organization apparently has gone beyond what the law would require in terms of disclosure. I wonder if you think the law for the applications for a tax-exempt organization should perhaps be amended to include the name of the affiliated politician. Your organization—the application for tax-exempt does not require the identification of the politician that's associated with it, and I wonder if you think that in the interest of disclosure that that would be appropriate.

Ms. KEYS. I mean certainly it would be appropriate, but rather irrelevant. I think you understand that when you apply for a new 501(c)(3), before an organization is actually established, what that application is is kind of a nominal put-together, two or three people that are interested in it and willing to say yes, I'm a director of it, we'll serve as the director of it, two or three people who will say they will serve as the requisite officeholders of it, and the application is submitted and then the work of really developing the organization goes on, and until that organization is more fully developed, it probably—you know, it would not help a great deal to require that.

I think it would certainly be perfectly fine in the case of something that is founded by a political leader to require that, or require if there is kind of one catalyzing person that is the attraction to found this policy center. But I really don't think that's the problem.

If I might just respond a little bit further, I do believe that there ought to be that requirement and, indeed, Senator Hart, who founded the Center for New Democracy did introduce into the Senate last year a bill which would have required—would have gone to the rules of the Senate and the House and would have prohibited any Member of Congress to be associated with a 501(c)(3) that did not disclose its contributors and its receipts and expenditures.

It seems to me that's kind of a basic necessity, as we all understand what we've done in terms of our campaign laws and the FEC requirements of campaigns, that we make everything visible, so that there can't be hidden kind of agendas, et cetera, or hidden strong influences upon what's happening in a campaign. I think that must carry over so that the public can be assured that there is not some hidden agenda in establishing a center, that it is being established in the public interest and, of course, the open disclosure of receipts and expenditures make very clear what's happening in the open disclosure of the activities of that 501(c)(3).

Mr. FLIPPO. Well, I'm sure our distinguished panel is aware of the public perception that exempt organizations are sometimes set up by politicians to circumvent tax and election laws. We are trying to address those concerns.

I might ask about the policies of your organizations regarding the use of your research findings or payment of travel expenses or the use of your mailing list by other organizations. Do you permit other organizations to use your mailing list?

Ms. STRANGE. I do not believe they are, I would have to get clarification on that, but I do not think so.

Ms. KEYS. As of yet we don't, our mailing list is controlled by our direct mail person, and it's not very large, since we're a rather new organization. We have about 1,565 or so on our membership network and contributors. And we do, certainly, have control if it is to be used.

I must say that we have been given mailing lists by other people in response—I mean, with the agreement that they would help us and we would share our mailing list with them. And that kind of swap, of course, goes on all the time, and certainly as we develop a little bit larger mailing list we will be glad to return the favor to other organizations who were able—who were willing to share with us their membership lists, et cetera.

Mr. FLIPPO. How about travel expenses?

Ms. STRANGE. The travel expenses for the organization and foundation itself, of course, is borne by the revenue that comes in. As far as expenses associated with Senator Dole, he does not make specific trips for us. Occasionally, when he is already in a city he will host a breakfast or some other event, but he does not make specific trips just for the foundation.

Mr. FLIPPO. And therefore, does not have travel expenses?

Ms. STRANGE. Absolutely.

Mr. FLIPPO. Is that essentially the same for you?

Ms. KEYS. Travel expenses are paid for anyone who makes a presentation at our seminars or conferences, that includes other Members of Congress that have been parts of delegations to our conferences, as well as anyone who makes a presentation. And in that respect, there has been payment of Senator Hart's travel to chair a seminar.

Mr. FLIPPO. I think the final question that I would have is, do you think current laws pertaining to election laws and tax laws and disclosure laws are sufficient to meet public concerns in this tax-exempt area?

Ms. **Strange**. I think my limited information in that field that I would have to say that I think the public is entitled to know what goes on within the organizations, and we certainly are amenable to having our books opened, and I think that should be true of all foundations and all organizations.

Mr. **Flippo**. Mr. Schulze.

Mr. **Schulze**. Thank you, Mr. Chairman. I'd like to thank the panel, their presentation has been very interesting.

Were all the panel members present when former Commissioner Cohen testified this morning?

[A chorus of noes.]

Mr. **Schulze**. None of you were. I'm sorry that you were not, because he presented an array of cases in which there was varied political involvement. I would like to have asked you if you felt you fell into that arena.

Well, then let me ask some questions. Ms. Strange, you say that the Senator does not accept expenses from the foundation when he's traveling.

Ms. **Strange**. I said, that as far as I know he has not been asked to make specific trips to bear expense for the foundation.

Mr. **Schulze**. When there are grants given, are they called Dole grants or are they called Senator Bob Dole grants? Does Bob Dole ever go and make the presentation and say, "What a great guy I am, here you are, see all the good I'm doing," or do you just send a check off? I realize we're talking about a fine line, but I'm trying to determine how much involvement there is?

Ms. **Strange**. During my very brief tenure I can tell you that, that there has been almost no involvement at all. In fact, he made it very clear to me during my initial meeting with him that this was a separate entity, that he was hiring me to be the chief executive officer, and that the only thing I would look to him for as chairman of the board was that there would be policy decisions which, of course, govern the foundation, but that it is separate, and that he wanted me to understand that very clearly.

Mr. **Schulze**. Did he tell you to bend over backward not to be political?

Ms. **Strange**. Well, he didn't have to tell me that, because I've lived in an arena where I have steered clear from being political for 40-years, and that's just not my nature. And I can assure you that I think he understands that. He didn't use those words with me, but he gave me the understanding that it was—the purpose of the organization was to assist those persons with disabilities, and that it was not to be a political tool.

Mr. **Schulze**. Of course, you haven't been there long enough, I guess, to answer some of these questions.

Ms. **Strange**. I'll try.

Mr. **Schulze**. I was going to ask you, in your fund raising whether those lists are ever used by any of the Senators' political campaign?

Ms. **Strange**. I believe the answer to that would be, absolutely not.

Mr. **Schulze**. Absolutely not. Thank you.

Martha, welcome, it's nice to have you back.

With Senator Hart being a prominent candidate, in the description this morning there was someone who was obviously a candidate who had set up a foundation so that it could pay his expenses. Can you describe for me the relationship of your organization? Would you say that it's an arm's-length relationship, that at seminars and so forth Senator Hart's name is not prominent or it is prominent or it's a forum for his philosophy or ideas to become exposed? Just how would you describe it.

Ms. KEYS. No. I think the length has been quite far. Its been important that Senator Hart has been willing to participate in, not all of our seminars and conferences, but in quite a number of them, because that has helped us attract, it has enhanced our ability to attract the wide range of experts.

We're nonpartisan, we've had former members of the Reagan administration. We've had people that, if you insist on looking at ideological spectrum of left to right, you could find on either end of them. Our series of six economic seminars, have been about some of the largest questions that we're facing, four or some on macroeconomic issues, two on work place issues. And in each case they've been 2½ hour seminars that have brought together about 12 people to make a presentation and to speak.

Several of our other board members have——

Mr. SCHULZE. Have these been in various parts of the country——

Ms. KEYS. Oh, yes.

Mr. SCHULZE [continuing]. Are they all in the same place?

Ms. KEYS. No, no. They've been held in various parts of the country, Dallas, Atlanta.

Mr. SCHULZE. Was there local media coverage?

Ms. KEYS. Some, yes. We all—we certainly try to get it, and we've had some very good coverage at times.

Mr. SCHULZE. Did the coverage focus on the Senator or on the topic?

Ms. KEYS. Obviously, our interest and the Senator's interest is that it focuses on the substance, and every effort is made to do that; in some cases you fail. You know yourself how irritating it is when you're trying to talk about something of substance, to be faced with political questions from reporters. Nobody can, you know, completely avoid that, but it's certainly considered a failure on all points when that happens.

Mr. SCHULZE. Tell me about the Center for New Democracy's fund raising procedures, successes, failures, how you do it? Who does it? Do you hire an outside firm or do you do it in house?

Ms. KEYS. We've had direct mail, which we've had an outside firm for. We've had about three different direct mail efforts that have been very successful. A great deal of it has—I have a development coordinator in the office that really spends full-time working at fund raising in a variety of ways. A lot of it has been done in terms of personal work by myself; some by other board members. Some of the board members have been very helpful in fund raising.

Initially, if you notice on the stationery, there is a list of founders. And there were a group of people initially who supported strongly the idea and wanted to help see that the Center for New

Democracy was founded and made a sizable financial contribution. Frankly, a commitment of 25,000 to the center, which enabled us to open our doors, hire staff, really go about the work of beginning, economic seminar work and international conferences.

Mr. SCHULZE. Are those people also large contributors to the Senator's Presidential campaign?

Ms. KEYS. I frankly don't know. I'm sure some of them are, but since I don't know any—I don't see the list of contributors to Presidential campaigns.

Mr. SCHULZE. One of the examples that we were given was an example of a potential Presidential candidate who would go out and form a 501(c)(3), and develop a mailing list for people who were sort of philosophically attuned, and use that mailing list and contributors list in a campaign. And that was given as an example of something that would be blatantly wrong, and something that we should look into.

Do you want to give me your thoughts on it?

Ms. KEYS. Yes. I would certainly agree with that. And I think it's very interesting that in our case it has been just the reverse. The ability of the center to do its work has been based initially on certainly being able to rent some of the Hart list, and people who did support Senator Hart and did care very much about the policy effort that it was his interest in founding to operate independently on a nonpartisan basis, were the ones that became part of that membership.

So, we owe a lot, again, those lists were rented appropriately, you know, we had to pay for them, this wasn't anything that was the other way. But I think it ought to be noted that, certainly in the case of the center, it has been the other way around. In fact, it hasn't been that we've been out trying to develop new lists, its that we've been very seriously wanting to get at this business of bringing together a wide spectrum of both new thinkers and doers, as well as the more well-known policy establishment, to try to tackle some of these new problems and to try to catalyze the developments and new solutions.

Mr. SCHULZE. Have the location of those seminars been nonpolitical? Have they been in the early primary States cr anything like that?

Ms. KEYS. Oh, no. No, no. Not at all. And if you will notice, I did——

Mr. SCHULZE. Have any of them been in New Hampshire or Iowa?

Ms. KEYS. No. No. Dallas, Cleveland, Detroit, New York, Atlanta, Laguna. Second Pacific Conference that was held in Korea. I mean, these are not high return States or high return locations.

No. And if you will notice in each case our seminars have been—we've had the assistance and the cosponsorship of some of the finest universities, some private sector organizations, some business groups, some labor groups. We don't go out and do things alone.

Mr. SCHULZE. I guess your relationship to the Senator is well-known, and that could be detrimental rather than an asset because they would say, well, of course, she's really helping him in his Presidential campaign. Has that been alleged or inferred?

Ms. KEYS. No. I think, also, you would acknowledge that my relationship to public policy and to national responsibility is also well-known. So, I think the record of my public life in the last 12 years makes it eminently clear that I'm very seriously interested in national policy.

Mr. SCHULZE. Do you feel a greater burden because you have to kind of bend over backward to make sure that that's not viewed that way?

Ms. KEYS. No, I really don't. I feel that, again, having been elected to Congress at the same time as Gary Hart, and having served as a colleague during the time he was also in the Senate, on the other side, and continuing after that to work in the executive branch to do a lot of things directly related to policy change. And I have—our paths have crossed many times, when we've been interested in some of these functions. I really don't think that's a problem. And I think anyone who tries to either define my career by his or his by mine would be making a big mistake.

Mr. SCHULZE. Mr. Wallace, just one question. You've heard this sort of degrees of involvement; your views is that the area you're testifying on was of the extreme.

Mr. WALLACE. I believe it would be an extreme example.

Mr. SCHULZE. How do we fence these areas off? How do we say, yes, you can go so far, because it seems to me there's such a variety of opportunity here that if we are going to build fences they have to be firm straight fences. It looks like it's almost an impossible task. Do you have any thoughts on how that should be done?

Mr. WALLACE. We have a situation with the Congressional Club that I think is extremely unusual, and perhaps, beyond what this committee will hear about in virtually any other case. We have a situation in which on the form 990 of the Coalition for Freedom, for instance, it is affirmatively disclosed that the coalition is affiliated with the Congressional Club, the Congressional Club Foundation, the Jefferson Marketing, and the Educational Support Foundation.

That doesn't go very far, though, to preventing the performance of the tasks of these various organizations in conjunction with one another for, what I believe to be one purpose, that is, the promotion of the candidacy and the philosophy of Senator Helms.

The disclosure of affiliation does not accomplish much.

Mr. SCHULZE. You don't think disclosure alone is an important factor or is a sufficient factor.

Mr. WALLACE. Well, it's apparent that disclosure of these relationships over the years have not resulted in any serious scrutiny by the service of these particular organizations.

It's apparent to me by examining the form 990s filed by the Coalition for Freedom that the efforts of the Coalition have directly coincided with the efforts of Senator Helms.

For instance, in 1983 expenditures for direct mail in the amount of some $300,000. My suggestion would be that that expenditure was part of the development of a mailing list that would be useful to the Senator in his 1984 campaign.

Mr. SCHULZE. Should we look more at fund raising in the way the money is raised or should we look more at the use to which these funds are put?

Mr. WALLACE. My examination of the Coalition for Freedom suggests to me that, the funds have been used, not externally but for the most part internally to develop mailing lists and with the coincident result of keeping the revenues flowing for the related organization of Jefferson Marketing.

I don't think controls——

Mr. SCHULZE. Do you think prohibition of that type of use—you see, as Mrs. Keys testified, that there's sort of this synergistic relationship with others, and I, you know, would hate to just say, you cannot share a mailing list with anybody else. And yet, there perhaps is room for abuse, if you want to walk along the fine line.

Mr. WALLACE. My experience in North Carolina is that, the development of the mailing list of the Congressional Club as maintained, I believe, by Jefferson Marketing, has been conducted for the purpose of promoting the Club, the Club's candidates, in particular, Senator Helms.

I think we face in North Carolina a situation that is reverse of what we're experiencing with the Center for New Democracy. We have mailing list development for a candidate.

As I say, the expenditures are largely internal. There were only modest expenditures in each year by the Coalition for Freedom in the production of television advertising or in the course of making contributions, other 501(c)(3) organizations.

I'll note particularly that there was an expenditure in 1985 by the Coalition for Freedom for a television program entitled, "Bias in Media," which was coincident with Senator Helms attempt to take over CBS through another vehicle, Fairness in Media.

We have an unusual situation in North Carolina, and I think there are—there is a need to address that unusual situation, first, through efforts at enforcement, through appropriate enforcement. That approach has not been tried.

Mr. SCHULZE. I must say that I am impressed by the array of titles: The Congressional Club Coalition for Freedom, the Center for New Democracy, and People for the American Way. They're all very impressive.

Thank you, Mr. Chairman.

Mr. FLIPPO. Thank you.

We appreciate very much the testimony of our witnesses. Thank you for sharing with us your views.

Our next panel will be Paul Egan, who is the deputy director of the National Legislative Commission of the American Legion.

We have John Heilman, who is the national legislative director of the Disabled American Veterans, and we have James Magill, who is the director of the National Legislative Service, the Veterans of Foreign Wars of the United States.

Gentlemen, we are pleased to have you here. You have heard the other testimony, and you know that we will include in full your testimony as written. So we would ask that you summarize your testimony. We are delighted to have you. Please proceed as you deem appropriate.

Mr. Egan.

STATEMENT OF PAUL S. EGAN, DEPUTY DIRECTOR, NATIONAL LEGISLATIVE COMMISSION, THE AMERICAN LEGION

Mr. EGAN. Thank you, Mr. Chairman.

We appreciate the opportunity to be here. I think all too often, veterans' organizations, as a collection of organizations, tend to get confused with other kinds of charitable organizations, and it's good that we're here to be able to draw some distinctions.

In the letter of invitation to testify this morning, we were asked basically three questions: the extent to which the American Legion is a lobbying organization, the extent to which we're engaged in political activity, and the extent to which we agree that current law governing veterans' organizations under the Tax Code is appropriate.

To the question of the extent to which we engage in lobbying activity, I would have to say that we are engaged in that activity at a modest level, and if you look at the amount of our annual operating budget that is devoted to lobbying, by contrast to the total budget, it amounts to 1.4 percent, at least in 1985. Oftentimes, in fact, the lion's share of the times that we make presentations to the Congress, is in direct response to inquiries from individual committees, most particularly the two Veterans Affairs Committees.

The extent to which we are engaged in political activity is the easiest question to answer. We are not engaged in political activity at all. We are a congressionally chartered organization, and section VI of that charter reads that "the organization shall be nonpolitical and, as an organization, shall not promote the candidacy of any person seeking public office," and we adhere to that to the letter.

We are satisfied with current law. We are a 501(c)(19) organization, as opposed to (c)(3) or a (c)(4). We are satisfied that we have been given a separate identification under the law. Veterans are set apart from other charitables, and we believe for very good reasons.

First of all, I suppose the 501(c)(3) organizations are not allowed to use tax-deductible contributions in order to carry out lobbying activities while 501(c)(19)s, the veterans' organizations, are. The reason for that distinction is a reason that's been affirmed by the Congress repeatedly over the years.

First of all, 501(c)(3) organizations are widely diverse. They are generally unregulated, and because of Congress' fear that these organizations might come under the control of a few of the wealthiest contributing benefactors of those organizations, the risk has always been that those organizations might become the personal lobbying arms of those individuals.

On the other hand, veterans' organizations are much, much different. As federally chartered organizations, we are required to report, disclose to the Congress, our activities on an annual basis. This is House Document 99-154, which is an example of that kind of report.

Second, our membership isn't homogeneous, as it might tend to be in some of the other charitable organizations. Our members cut across political, racial, ethnic, and sexual lines.

Third, our organization operates in a truly democratic fashion. All of our officials, both in the State organizations and the national organization, are elected. The delegates to our annual national conventions are elected by the States. Those delegations are representative of the membership strength in each State. And the positions ultimately taken by the national organization are a direct product of debate by those delegates and acceptance of those positions.

Our lobbyists, of which there are four, completely comply with the Federal Regulation of Lobbying Act of 1946 by registering with the Clerk of the House and the Secretary of the Senate on a quarterly basis.

And finally, we generally refrain from solicitation of tax-deductible contributions, other than what we get from a portion of the annual dues paid by each member. There are occasions when we have solicited tax-deductible contributions, but in those instances, the purpose for gathering the money was to turn it over to some other agency or activity for the purpose of carrying out some laudable goal. Examples include $1.2 million that we raised for the construction of the Vietnam Veterans Memorial. Before that, we had raised $500,000 that we turned over to the Congress for the purpose of casting a replica of the Freedom Bell during the Bicentennial, and prior to that on one occasion, we raised $1 million for cancer research.

The distinctions between 501(c)(3)s and 501(c)(19)s, in fact, were upheld most recently by the Supreme Court in 1983. At that time, a case involving Donald Regan, Secretary of the Treasury, versus Taxation with Representation, arose when Taxation, which was operating a 501(c)(3) and 501(c)(4) operation sought to combine their activities and continue to lobby. They applied to be categorized as 501(c)(3), and they were turned down, and, of course, the case went to the Supreme Court, which decided that because there are distinctions between veterans' organizations and other 501(c)(3)s, that their claim was not to be upheld.

They felt they were being denied equal protection under the law, since they were being denied an opportunity to lobby as a 501(c)(3), while veterans' organizations were permitted to lobby as 501(c)(19)s.

That concludes my summary.

[The prepared statement follows:]

STATEMENT BY PAUL S. EGAN, DEPUTY DIRECTOR
NATIONAL LEGISLATIVE COMMISSION
THE AMERICAN LEGION
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
WAYS AND MEANS COMMITTEE
U.S. HOUSE OF REPRESENTATIVES
MARCH 13, 1987

****

Mr. Chairman and Members of the Subcommittee:

The American Legion appreciates this opportunity to present its views on the current status of our organization as tax exempt under section 501 (c)(19) of the Internal Revenue Code. In your letter of invitation to testify at today's hearing we were asked to address three basic issues. These include the extent to which The American Legion undertakes lobbying activities, the extent to which the Legion engages in political activity and whether current tax law applicable to the Legion is appropriate to our organizational needs.

Before addressing each of these, it may be instructive to discuss the historical perception of veterans organizations by the Congress in treating veterans organizations differently from other non-profit groups. Moreover, veterans organizations are categorized under 501 (c)(19) of the tax code while many other non-profits are categorized under 501 (c)(3) of the tax code. As for our category, 501 (c)(19) is exclusively reserved for veterans organizations. The difference between veterans groups under the tax code and many other non-profits is that the others are denied continued tax exempt status under 501 (c)(3) if they engage in lobbying. Veterans groups, on the other hand, may retain their tax exempt status even though they engage in lobbying activity.

More specifically, in making this distinction Congress has expressed its sense that no tax deductible contrubution to charitable organizations under 501 (c)(3) should be used for lobbying. The reasons for this have been predicated on an understanding of the varied and generally unregulated nature of most charitable organizations. Should tax deductible contributions be allowed to be channeled into lobbying activity, for example, Congress has feared that many of these organizations would fall into the control of their wealthiest benefactors and become a lobbying arm in pursuit of the private interests of a few of the largest contributors.

Veterans organizations are significantly different from most 501 (c)(3) organizations and have built-in controls to prevent the occurrence of the abuses for which Congress has expressed concern. Unlike other groups, veterans organization members are heterogeneous with members cutting across political, racial, ethnic and sexual lines. For this reason, it is unlikely that veterans organizations would adopt positions contrary to a majority of their members. The Legion, for example, operates its own democracy throughout the process of electing its officials, convening its annual conventions and adopting its positions on a wide range of issues. In that regard, it is the delegates to our national convention, elected by Legion members in each state, who debate the issues on the convention floor before approving the national resolutions that constitute the positions taken by the National Organization.

Veterans organizations are also different by virtue of being congressionally chartered and operating within the strict parameters of their respective constitutions and by-laws. Each year we are required to report our activities to Congress in the form of an annual report, a public document prepared by the Government Printing Office. This fact alone enables annual congressional oversight of veterans organization activities. As federally chartered organizations, we fully comply with the Federal Regulation of Lobbying Act of 1946, P.L. 79-601, by registering our lobbyists quarterly with the Clerk of the House and Secretary of the Senate. On balance, the internal controls and congressional oversight of veterans groups sets us clearly apart from other organizations prohibited from lobbying under 501 (c)(3) of the code.

As a matter of policy, The American Legion refrains from solicitation or acceptance of any tax deductible contributions other than nominal annual dues for its own purposes without the specific consent of our National Executive Committee. It has, on occasion, solicited tax-deductible contributions from its members to be given to others for public or quasi-public purposes. Examples of these instances include raising $1.2 million for the erection of the Vietnam Veterans Memorial, $500,000 which was given to the federal government to cast a replica of the Freedom Bell during the Bicentennial and over $1 million for cancer research. Here again, the Legion's internal controls have prevented the raising of charitable contributions for anything other than the specific laudable purposes for which the donations were sought.

Moreover, to use some perhaps dated statistics for illustrative purposes, in 1978 contributions, gifts and grants to all 501 (c)(3) organizations totalled about $22 billion. This is nearly 1500 times the $16.7 million given to veterans organizations the same year. This substantial disparity, taken together with the special characteristics of veterans organizations, offers a convincing suggestion about why Congress has never needed to restrict the lobbying activities of veterans.

As we have shown, there are several reasons for distinguishing veterans groups from others and these reasons were most recently acknowledged by the Supreme Court on May 23, 1983. The case decided at that time, Donald Regan, Secretary of the Treasury, ET AL. v Taxation With Representation of Washington, involved a non-profit group arguing a denial of equal protection under the law. Taxation With Representation (TWR) claimed that Treasury's denial of their right to lobby under 501 (c)(3) deprived them of a privilege granted to veterans groups under 501 (c)(19).

The Court's decision, in part, held that Congress, "-- not TWR or this Court -- has the authority to determine whether the advantage the public would receive from additional lobbying by charities is worth the money the public would pay to subsidize that lobbying, and other disadvantages that might accompany that lobbying. It appears that Congress was concerned that exempt organizations might use tax-deductible contributions to lobby to promote the private intrests of their members..."

"It is also not irrational for Congress to decide that, even though it will not subsidize substantial lobbying by charities generally it will subsidize lobbying for veterans' organizations. Veterans have been obliged to drop their own affairs and take up the burdens of the nation subjecting themselves to the mental and physical hazards as well as the economic and family detriments which are peculiar to military service and which do not exist in normal civil life. Our country has a longstanding policy of compensating veterans for their past contributions by providing them with numerous advantages. This policy has always been deemed to be legitimate."

With this background having been laid before the Subcommittee, we shall now turn our attention to answering the specific questions under consideration at today's hearing. The extent to which the Legion undertakes lobbying is modest although we consider our activities to be effective, particularly in matters of direct relevance to veterans affairs.

The term modest is justified here when a comparison of the National Organization's total operating budget for 1985 is compared to the amount allocated to the National Legislative Division, the lobbying arm of the Legion. The total operating budget was approximately $23 million and the Legislative Division's budget was approximately $320,000. Most of this $320,000 is devoted to employee salaries and benefits. Stated in other terms, a mere 1.4 percent of the Legion total operating budget was explicitly allocated to lobbying activity. The same was true in 1986 and is true this year. It should be added here also that a substantial part of the Legislative Division's activities involve responding to specific requests from congressional commitees for testimony by Legion spokespersons. According to the law, responding to requests of this nature is not considered lobbying.

In that regard, the Legion assures its members that the integrity of their views -- and not those of Legion spokespersons here in Washington, DC -- are represented by generally refraining from offering comment on issues unless a specifically approved resolution on the subject has been approved at either a National Convention or one of two annual meetings of our National Executive Committee. To assure Legion views are current, resolutions adopted each year that call for legislative relief are limited to a single Congress. A resolution approved by the Legion during the 99th Congress must be reapproved subsequently in order to apply to the 100th Congress.

In response to the question of how extensively the organization engages in political activities, the answer is quite clear. The Legion's congressional charter specifically forbids political activity and compliance with this prohibition is strictly obeyed. Section 6 of our charter is explicit on this matter and states, "That the organization shall be nonpolitical and, as an organization, shall not promote the candidacy of any person seeking public office."

The third and final question to be addressed regards the appropriateness of current tax law applicable to The American Legion. In that regard, we are satisfied with the tax law classification of 501 (c)(19) as it is presently. We believe the

Legion should continue to be allowed its tax exempt status without restrictions being imposed on lobbying activity.

Apart from its modest lobbying activity, the Legion continues to make generous contributions to beneficial causes in communities across the nation. Examples of this abound on review of our Consolidated American Legion Post Report. In the report for 1985-86, with only 52.69 percent of all Legion Posts around the country reporting, virtually millions of dollars have been raised locally for Legion baseball, student scholarships, oratorical contests, Boys State and school award programs, patriotic events and contributions to a host of other charitable organizations. Tens of millions of hours have been volunteered by Legion members in VA hospitals, community services and in assisting veterans with employment problems.

Mr. Chairman, we hope this information is useful to you and the Subcommittee as it reviews the status of veterans organizations under current law. In summary, there are numerous good reasons why our special status under 501 (c)(19) should be retained. You and your colleagues have historically retained this special status and the Supreme Court has recently upheld that special status. We hope you agree that it should continue to be retained.

Mr. Chairman, that concludes our statement.

Mr. **Flippo**. Thank you very much, Mr. Egan.
Mr. Heilman.

STATEMENT OF JOHN F. HEILMAN, NATIONAL LEGISLATIVE DIRECTOR, DISABLED AMERICAN VETERANS

Mr. **Heilman**. Yes, Mr. Chairman. I will summarize my statement.

The Disabled American Veterans is a congressionally chartered veterans' organization founded in 1920, shortly after World War I. We received our charter in 1932. The membership criteria for our organization is the incurrence of a service-related wound, injury, or disease during wartime service. We presently have in excess of 1 million members nationwide with a Ladies Auxiliaries of over 100,000.

The DAV is a 501(c)(4) organization under the code, and contributions to us are deductible under 170.

In my statement, I have outlined the various programs and services that we provide to veterans, their dependents and survivors, free of charge whether they are members of the DAV or not or, in fact, eligible for membership in the DAV or not.

The most obvious program is our national service program. We employ 245 national service officers nationwide who represent veterans and their dependents and survivors in making application for claims before the VA. That program requires in excess of $24 million a year to operate.

And as you will note, Mr. Chairman, we also participate in the volunteer VAVS program, the hospital—voluntary service in hospitals, in terms of man-hours and contributions. We have a disaster relief program, an emergency relief program, scholarships for needy children of disabled veterans, et cetera.

In terms of our Federal legislative activities, the DAV employs four full-time registered lobbyists here in Washington, DC, of which, of course, I am one. Our primary focus in terms of our activities on Capitol Hill deals with VA benefits and services based on military service, and in terms of the DAV, we even have a more narrow focus, because we are primarily concerned with those VA benefit programs that have as a portion of their eligibility criteria the incurrence of that service-related wound, injury, disease, or death. So therefore we pay particular attention to the service-connected disability compensation and death programs, chapter 31 benefits, which is vocational rehabilitation for service-connected disabled veterans, and, of course, hospital and medical care.

We are nonpartisan. Our congressional charter and our own constitution and bylaws prohibit us from being involved in partisan politics. We do not have a political action affiliate. And in terms of our political activity, although our presence, I would imagine, could be said to be felt quite a bit sometimes on Capitol Hill, in terms of the overall operation of our organization and its employees, our lobbying efforts are, in fact, less than substantial, to my understanding of that term, as I've heard it used here this morning.

Finally, we have no problem with carrying out our advocacy actions on behalf of veterans under current law and regulation.

[The prepared statement follows:]

STATEMENT OF
JOHN F. HEILMAN
NATIONAL LEGISLATIVE DIRECTOR
DISABLED AMERICAN VETERANS
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
OF THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
March 13, 1987

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

On behalf of the over 1.1 million members of the Disabled American Veterans and its Ladies' Auxiliary, may I say that we appreciate this opportunity to participate in today's hearing in discussion of the lobbying and political activities of organizations that have a tax exempt status under Section 501 of the Internal Revenue Code.

Before commenting upon this subject, I believe it is pertinent to provide the Subcommittee with a few words of background information concerning our organization and its various programs and services that are extended to America's veteran population, their dependents and survivors.

The DAV...Who We Are and What We Do

The Disabled American Veterans (DAV) was formed by a group of disabled World War I veterans in 1920. It was chartered by Act of Congress on June 17, 1932, and was incorporated in the state of Ohio in 1938. The DAV has been granted an exemption from taxation under Section 501(c)(4) of Title 26, United States Code, as amended, and its principal office is located at 3725 Alexandria Pike, Cold Spring, Kentucky. The DAV also maintains a National Service and Legislative Headquarters here in Washington, D.C., located at 807 Maine Avenue, Southwest.

The purposes of the DAV, as set forth in its Constitution and By-Laws, are to uphold and maintain the Constitution and laws of the United States; to realize the true American ideals and aims for which those eligible to membership fought; and to advance the interest and work for the betterment of all those who have become wounded, injured and otherwise disabled as a result of wartime military service in our nation's Armed Forces, as well as their dependents and survivors.

Eligibility for membership in the DAV is restricted to veterans of honorable wartime military service who have incurred a service-related wound, injury or disease. At present, the national membership of the DAV is 1,009,797, with a Ladies' Auxiliary of 119,468.

The most important program of the DAV is its National Service Program. This program involves employment of some 245 National Service Officers (NSOs) who are also service-connected disabled veterans. These NSOs are recognized by Congress as "attorneys-in-fact" and, as such, are authorized to represent veterans (both disabled and non-disabled), their dependents and survivors before the Veterans Administration's Rating Boards, in determining compensation, pension, hospitalization and other benefit entitlement. Representation is also offered by the DAV to veterans who file claims for Disability Insurance Benefits (DIB) of the Social Security Administration and to veterans who file claims with the military's Discharge Review Boards and Boards for Correction of Military Records.

This representation is offered free of charge, to all veterans, their dependents and survivors, as the expenses of the National Service Program -- which presently requires in excess of $24 million per year -- are paid for by funds raised by the DAV. The National Service Program has offices located in every Veterans Administration regional or district office in the United States and DAV NSOs regularly visit every VA hospital.

In addition, the DAV maintains an appeals office here in Washington, D.C. to handle the appeals of veterans, their dependents and survivors who have received adverse benefit determinations by VA agencies of local jurisdiction.

The DAV also maintains other programs which provide services and benefits to its membership and/or the veteran community at large. Among these programs are:

* a National Employment Program;

* a National Legislative Program;

* a fleet of Field Service Units which seek out veterans who do not have access to VA regional offices;

* an Older Veterans Assistant Program (OVAP) designed to meet the needs of elderly veterans;

* a Transportation Program designed to assist veterans in traveling to a from VA medical facilities;

* participation in the Veterans Administration's Volunteer Services Program (VAVS);

* an Educational Scholarship Program for the children of needy disabled veterans;

* a program of financial relief for veterans who are victims of natural disasters; and

* a program of financial relief for veterans who are in need "emergency" assistance.

In Calendar Year 1986, the latter four programs provided:

1. Over 1.7 million man-hours of voluntary service and over $500,000 in monetary/material contributions to VA hospitals through the VAVS program.

2. $606,737 in college scholarship assistance to the children of needy disabled veterans.

3. $219,586 in direct monetary assistance to veterans who fell victim to "natural disasters."

4. $635,928 in direct monetary assistance to veterans who found themselves in emergent financially precarious situations.

The DAV's primary source of revenue to conduct its tax exempt operations is realized through an entirely "in-house" administration of direct solicitations to the general public. Contributions to the DAV are deductible pursuant to the provisions of Section 170 of Title 26, USC. Pursuant to Public Law 88-504, the annual financial statements of our organization are transmitted each year to the Office of the Comptroller General of the United States, through the House Judiciary Committee.

Federal Legislative Activities

As mentioned earlier, the DAV administers a National Legislative Program, the mission of which is to initiate and support legislation beneficial to our nation's veteran population, their dependents and survivors, in terms of their entitlement to federal benefits and services predicated upon military service in America's Armed Services, such benefits being administered primarily by the Veterans Administration.

Presently, the National Legislative staff of the DAV numbers four individuals, all service-connected disabled of the Vietnam Era, three of whom incurred combat disabilities in Vietnam. All are registered as lobbyists and, pursuant to the Federal Regulation of Lobbying Act, file quarterly reports of their activities to the Clerk of the House of Representatives and to the Secretary of the Senate.

While the DAV maintains a strong interest in all veterans' programs, by direction of our membership in National Convention assembled, we have over the years maintained a primary focus upon those programs whose eligibility criteria require the incurrence of a service-related wound, injury, disease or death.

Such programs include, but are not limited to:

* disability compensation for service-related conditions (Chapter 11, Title 38, USC);

* survivors' benefits based upon death due to a service-related condition (Chapter 13, Title 38, USC);

* inpatient and outpatient medical care and services (Chapter 17, Title 38, USC);

* vocational rehabilitation provided to service-connected disabled veterans (Chapter 31, Title 38, USC); and

* educational assistance to certain dependents and survivors of totally disabled service-connected veterans and veterans who have died from service-connected causes (Chapter 35, Title 38, USC).

DAV legislative mandates and policy positions are derived annually from measures that have been approved, in resolution form, by the delegates to our Annual National Conventions or by actions of our organization's National Executive Committee.

These initiatives are then communicated to certain officials in the Executive Branch (VA, primarily), members of Congress and appropriate standing Committees and their staffs. With the cooperation of members of Congress, these initiatives are introduced as bills in the House and Senate and our organization, along with Administration officials and other interested parties, participates in the Congressional hearing process.

In addition to the lobbying activities of the DAV's legislative staff, other officials and members of our organization may, from time to time, be involved. Examples of such involvement include: testimony by our National Commanders and/or other DAV officials to Committees of the Congress, testimony of state and local DAV officials at "field hearings" conducted by Committees of the Congress and, of course, "grass roots" communications from our national membership to their elected officials on Capitol Hill. (Appeals for grass roots efforts to our membership are made through the DAV Magazine and through written and electronic communications.)

DAV expenditures related to legislative/lobbying activities at the federal level do not comprise a significant portion of our organization's revenues. For example, in Calendar Year 1986, expenditures on legislative activities amounted to 6/10 of one percent of total revenues.

Finally, the Disabled American Veterans, while certainly engaged in political activity, does not engage in partisan politics. We are forbidden to do so by our own Constitution and By-Laws and by our Congressional Charter. Consequently, neither the National Organization of the DAV, nor any of its state department or chapter affiliates endorses, opposes or financially contributes to the candidacy of any individual for public office at any level (federal, state and local). The Disabled American Veterans does not have a Political Action Committee (PAC) affiliate.

This completes my statement, Mr. Chairman. In closing, I can state that in terms of our organization's federal legislative activities and actions associated with advocacy on behalf of our nation's federal system of benefits and services, the DAV does not find itself to be constrained, in any way, by current law and regulation. I will be pleased to answer any questions you may have at this time.

Mr. **Flippo**. Thank you very much.

Mr. Magill?

STATEMENT OF JAMES N. MAGILL, DIRECTOR, NATIONAL LEGISLATIVE SERVICE, VETERANS OF FOREIGN WARS OF THE UNITED STATES

Mr. **Magill**. Thank you, sir.

The Veterans of Foreign Wars is also a congressionally chartered veterans' organization, and we have a membership of 2.7 million men and women of the VFW and our Ladies' Auxiliary.

We limit membership to only those who have actively served overseas in a time of war, and we enjoy tax-exempt status under section 501(c)(19) of the Internal Revenue Code.

VFW, as the rest of the organizations up here, has numerous programs that serve the community and the nation. Our projects involve community renovation, health care, environmental concerns. We work with schools, churches, other community organizations. Our aid extends to helping local hospitals, the needy, the handicapped.

Our national headquarters assists our local posts, which number approximately 10,000, with safety programs which provide education and assistance, driver's education, bicycle safety, fire prevention and home security, et cetera.

We work and put in very long hours working with the youth of the community and instructing them in Americanism and patriotism.

Of course, as our name implies, our membership consists of individuals who have served in our Nation's foreign wars, and because of this, one of our primary goals is to protect and enhance those benefits and entitlements that our nation's veterans have earned.

We have one registered lobbyist, and that is myself. We confine our lobbying activities almost exclusively to title 38 of the United States Code, and that is, of course, with the Veterans Administration. However, we do occasionally get involved in employment and housing matters as they pertain to veterans.

The Veterans of Foreign Wars does not participate in political activities.

You also asked whether we consider the current tax law applicable to lobbying and political activities of tax-exempt organizations to be appropriate to the needs of our organization. We believe our status under 501(c)(19) does meet the needs of the VFW and is appropriate.

This concludes my statement, sir.

[The prepared statement of James N. Magill follows:]

STATEMENT OF

JAMES N. MAGILL, DIRECTOR
NATIONAL LEGISLATIVE SERVICE
VETERANS OF FOREIGN WARS OF THE UNITED STATES

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

WITH RESPECT TO

LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

WASHINGTON, D.C. MARCH 13, 1987

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

Thank you for the privilege of appearing before this distinguished subcommittee. My name is James N. Magill and it is my honor to serve the more than 2.7 million men and women of the Veterans of Foreign Wars and its Ladies Auxiliary as the Director of their National Legislative Service.

The Veterans of Foreign Wars is a federally chartered veteran's organization which boasts 32 years of continuous growth. We limit membership to only those who have actively served overseas in time of war and at the direction of the President of the United States and the members of Congress. We are regarded as an extremely patriotic and community-oriented organization with over 10,000 posts throughtout the United States and, for that matter, the world. The Veterans of Foreign Wars enjoys tax-exempt status under section 501(c)(19) of the Internal Revenue Code.

Article I of the VFW Constitution reads: "The objects of this association are fraternal, patriotic, historical and educational; to preserve and strengthen comradeship among its members; to assist worthy comrades; to perpetuate the memory and history of our dead, and to assist their widows and orphans; to maintain true allegiance to the government of the United States of America, and fidelity to its Constitution and laws; to foster true patriotism, to maintain and extend the institutions of American freedom; and to preserve and defend the United States from all her enemies, whomsoever." In order to achieve these objectives, the VFW has numerous programs which impact on the national, state and local communities. Each year, the VFW sponsors dozens of community programs which benefit VFW members and non-members alike. The objectives of our Community Service Program are five in number. They are: (1) assistance to others in the community, (2) taking the initiative in leading the way for projects and programs of service to the community, (3) improving upon the projects and programs the Post or Auxiliary conducted in the past, (4) selecting and developing of new projects and programs to include established community service projects, and (5) developing a good public image for the VFW by informing people of what the VFW does in its Community Service Program.

These objectives are met through the dozens of projects and programs the VFW promotes each year. Community involvement includes projects in beautification, renovation, health care and environmental concerns. Cooperation includes projects with schools, churches and other community organizations. Aid to others extends the helping hands of Post and Auxiliary members to local hospitals, the needy, the handicapped and the senior citizens. In addition to these there are those programs devised by Posts and Auxiliaries to meet the needs of their particular communities.

Our National Headquarters promotes Safety programs which provide education and assistance in the areas of driver education, bicycle safety, fire prevention and home security, and hunter safety. It also recognizes outstanding contributions of firefighters, law enforcement personnel and emergency medical technicians through the Recognition and Public Commending Program.

Americanism and Loyalty Day programs stress the understanding and appreciation of the American way of life. Under this program, honor guards are provided for military funerals and for patriotic celebrations. Flags are presented to community organizations, and a flag appreciation program teaches people how to present and care for the American flag.

National Headquarters, through all the echelons of the VFW, promotes youth activities. A Voice of Democracy broadcast script writing contest, scouting, baseball, soccer, bowling and junior rifle teams are some of the areas served by this program. Realizing that the youth of the nation are the future of the nation, the VFW stresses programs which develop an appreciation of the American way of life, a sense of individual accomplishment and fulfillment, team effort and patriotism.

Of course, Mr. Chairman, as our name implies, our membership consists of individuals who have served in our nation's foreign wars. One of our primary goals is to protect and enhance those benefits and entitlements our nation's veterans have earned. To do this we consult with members of Congress and their staffs. The Veterans of Foreign Wars confines its lobbying activities to only those areas which serve veterans, their dependents and survivors; naturally, we work diligently toward the enactment of legislation beneficial to veterans and labor just as vigorously to defeat legislation which is detrimental. Almost all our efforts are directed toward Title 38 of the U.S. Code. However, occasionally housing and employment issues, as they pertain to veterans, receive our attention. We also, as directed by our Constitution, address issues relating to the national security of the United States.

Mr. Chairman, you also asked whether we consider the current tax law applicable to lobbying and political activities of tax-exempt organizations to be appropriate to the needs of our organization. We believe our status under 501(c)(19) does meet the needs of the VFW and is appropriate.

This concludes my statement. I will be happy to respond to any questions you may have.

Mr. **FLIPPO**. Thank you very much, and I thank all of you gentlemen, who represent very fine organizations and, in a way, you enjoy special privilege under the law, in that you are able to—first of all, you are tax-deductible. Contributions to your organizations are tax-deductible, and you are also able to lobby.

I wonder if you think perhaps there are other types or groups of tax-exempt organizations that should also be allowed this double benefit, such as all social welfare organizations, or perhaps trade unions, trade associations or labor unions.

Would you care to respond?

Mr. **EGAN**. Yes.

Mr. **FLIPPO**. Do you have any objections to these?

Mr. **EGAN**. I think it's important to recognize, you know, as I tried to point out in my summary, the distinctions that are internal controls that are present within organizations listed under 501(c)(19) which are not necessarily the case with every other 501(c)(3). And if this committee or if the Congress found some way of incorporating the same kinds of internal controls to shelter you from the fears that you collectively as a Congress have expressed in the past about the likelihood or possibility of an organization falling into the hands of the very fewest, of the wealthiest benefactors, if that was possible, then there certainly could be some sort of expansion.

Mr. **FLIPPO**. But other than—in other words, you're saying that if these organizations had the same kind of internal controls as your organizations do, then you would not object?

Mr. **EGAN**. I'm just simply trying to anticipate, on the basis of what I've read historically, what Congress' fears have been.

Mr. **FLIPPO**. I see. Any of the other panel members have anything?

Mr. **HEILMAN**. I would just say, Mr. Chairman, that as you noted, the Congress has acknowledged the special significance of war veterans' organizations, and of course the goals that they pursue with respect to those who served and sacrificed in time of war.

I'm probably going to sidestep your question by saying, personally I have no expertise or knowledge, and I hesitate to say anything without being aware of the ripple effects, and as an organization, I don't think we'd want to touch it, really.

Mr. **FLIPPO**. Mr. Magill.

Mr. **MAGILL**. I think I'm going to have to share the views with the representative from DAV—we, of course, have enjoyed a special exemption, and the Congress has recognized what the veterans have done, and we appreciate that very much.

Mr. **FLIPPO**. You can engage in lobbying activity, but you don't engage in political activity.

Mr. **EGAN**. That certainly is true of the American Legion.

Mr. **FLIPPO**. If you were permitted under the law to engage, are you under any pressures from your contributors or your people to—would you increase your lobbying activity or your political activity if the law permitted that?

Mr. **EGAN**. Let me address that by saying this. Our organization adopts positions on issues ranging across the entire political spectrum. For us to get in the business of supporting or opposing specific candidates, I think would be a mistake, because on Monday of any given week, depending on the issue that we're dealing with, our allies will be our opponents by Friday on another issue.

Mr. FLIPPO. Well, let me then pose the question: Do you think that the positions that you favor and the publication of that information is kind of educational—do you think that can become political, depending upon the timing of the release of that information?

For instance, at an appropriate or a critical time in a political campaign.

Mr. EGAN. I suppose that's possible, but it certainly isn't anything that we would intend to accomplish.

Mr. FLIPPO. Thank you.

Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman.

Mr. Egan, I guess your problem is actually a turnaround, because your problem is politicians taking a casual statement of praise by your organization and turning that into a political benefit.

Mr. EGAN. Of course, as we all know from the last election's experience, some people have accused us of engaging in political activity because of the award that we did give to Bob Edgar of Pennsylvania, which he, of course, used in a lot of publicized political advertising.

But from our perspective, there were three individuals who we could have offered the same award to. All three of them were House Veterans Affairs subcommittee chairmen, and all three of them were running for the Senate.

Mr. SCHULZE. Well, that is what I was thinking about. I guess no matter how far backward you bend over, somebody can accuse you of political involvement one way or the other.

Mr. EGAN. And it wouldn't be the first time.

Mr. SCHULZE. But I'd like to thank all three of you. As the chairman stated, we do know of your good works over the years, and the veterans in this country have benefited from your organizations. We wish you continued success.

Mr. FLIPPO. I just join my colleague. I would like to clarify one point that you made about your organization raising funds for the Veterans memorial, I believe.

I thought that the Vietnam Veterans Memorial was highly advertised as not being paid for by the Federal Government. Was it, in fact, paid for with tax-deductible funds, either through your (c)(19) or some other 501 entity? Were the contributions that——

Mr. EGAN. The contributions that we received from our members—and that's where we received the contributions from—were tax-deductible. We turned those contributions over to the Vietnam Veterans Memorial Fund, which I assume was a 501(c)(3). I have no idea, but I assume they were. And I further assume—at least I'm under the understanding that the memorial was completely constructed with private donations.

Mr. FLIPPO. But tax-deductible.

Mr. EGAN. I couldn't speak to that. I assume so.

Mr. FLIPPO. I just wanted to clarify that.

[The following was subsequently received:]

The American Legion

For God and Country

★ WASHINGTON OFFICE ★ 1608 "K" STREET, N.W. ★ WASHINGTON, D.C. 20006 ★
(202) 861-2700 ★

March 17, 1987

Honorable J. J. Pickle, Chairman
Subcommittee on Oversight
House Committee on Ways & Means
1105 Longworth House Office Building
Washington, DC 20515

Dear Chairman Pickle:

This letter is intended to clarify a question raised at the hearing of March 13. After having made the presentation on behalf of The American Legion, in which I cited the fact that the Legion had raised well over $1 million for erection of the Vietnam Veterans Memorial, Mr. Flippo asked how much the federal government had contributed to that cause.

Without realizing it at the time, Mr. Flippo was probably referring to the subsidy to the Memorial created by foregone revenues resulting from tax deductible contributions. In responding to this question the committee was advised that, as far as we know, the Memorial was built without any federal funding whatsoever. That response may have been incomplete given the foregone revenues from tax deductible contributions from so many veterans around the country.

In any event, we take the view that, with the exception of a few large contributions made by individuals directly to the Vietnam Veterans Memorial Fund, most contributions were probably never claimed as deductions by tax paying contributors. In our experience collecting contributions from Legion members, typical contribution denominations were between $5.00 and $20.00. To us this suggests contributions by non-itemizing tax payers who would most likely forego claiming the deduction on their tax returns. Moreover, we suspect the cost of these contributions to the government to have been relatively insignificant.

As always, The American Legion appreciates the opportunity to respond to Congressional inquiries into our activities. Hopefully, no misunderstanding arose from my incomplete response to the question addressed by Mr. Flippo.

Sincerely,

Paul S Egan

Paul S. Egan, Deputy Director
National Legislative Commission

Mr. FLIPPO. Thank you very much for your testimony. I appreciate your being here today. You've been very helpful.

Our next panel, we are pleased to have Robert Bothwell, the executive director for the National Committee for Responsive Philanthropy; Joseph W. Blackburn, who is the counsel of the Coalition of Health Services Organizations; and James Lescault, the executive director of the Urban Educational Systems, Inc.

Gentlemen, we are pleased to have you with us today. We appreciate your patience in staying with us through the other testimony. As you know, we will include your entire testimony in the record and would ask that you summarize your testimony before us today.

We might proceed as you deem appropriate, Mr. Bothwell.

STATEMENT OF ROBERT O. BOTHWELL, EXECUTIVE DIRECTOR, NATIONAL COMMITTEE FOR RESPONSIVE PHILANTHROPY

Mr. BOTHWELL. Thank you, sir. I appreciate the patience of the committee, too.

I will summarize my testimony, and I would like to offer a few comments based on some of what we have heard this morning.

The National Committee for Responsive Philanthropy currently is an organization of 250 member organizations nationwide. We were organized 10 years ago to pursue remedies to the closed doors in private philanthropy that deny information, access and funding to many charities. We have sought to expand the information that grant-makers provide to grant-seekers so that the latter can learn from the tens of thousands of corporations and foundations that are grant-makers which ones might be interested in their funding.

We have also sought to expand access to United Ways, foundations, and corporations so that charities can meet with real people and talk about their funding proposals.

We have helped organize joint fund-raising appeals comprised of local organizations which have been frozen out of the workplace, charity drives, so that they might independently raise workplace contributions from willing employees.

Along that same line, we have sought to open up the Combined Federal Campaign to permit the many vibrant and newer charities of recent years to participate and share in the $140 million raised and contributed by federal employees.

As you can imagine, these goals have not been acheivable overnight. The people within philanthropy who keep the doors closed, I think we can say, do it for one of two reasons: either they're ignorant of the benefits of open doors, or they simply benefit too substantially from having those doors closed and maintaining the status quo.

Regardless, the result is that the valuable charitable impulses that are seeded in newer charities and grass roots organizations do not grow and ripen, and we end up as a society poorer.

Lobbying and grassroots lobbying are very important to our efforts to change private philanthropy and to change public policy affecting private philanthropy. But lobbying, however essential, is only part of the whole. We also do research—we spend years sometimes putting together one research report. We publicize those reports so we can get wide exposure. We hold national conferences and regional conferences. We send people out into the field to provide technical advice to people who want collectively to raise money in ways they haven't done before.

And let us note that changing public policy affecting philanthropy may not just mean dealing with legislation. In fact, most of the time it means changing officials' minds, changing regulations, changing executive orders, none of which is prohibited under the current law affecting 501(c)(3) charities.

Our goals would be very hard to accomplish even if we had an unlimited supply of money and volunteers, and obviously we don't.

As a matter of fact, our total budget is only $330,000, which means—and I think it's important for the committee to understand this—that whatever activity an organization such as ours chooses to do, we have to piggyback it onto other activities, because we are under a mandate from the public—from public officials and from our contributors—to make sure we are cost-effective in whatever we do, and because we ourselves want to get the most bang for the buck. And, I think, contrary to what Mr. Sheldon Cohen indicated earlier, there are not any real clear differences between organizations that are "educational" or "lobbying," if in fact they are trying to affect and impact public policy, and that means changing regulations, officials' minds, as well as perhaps changing legislation.

Let me give you some examples of how "educational" and "lobbying" become so intertwined. When we send a newsletter out, it will contain background information about critical philanthropic issues that may at some time reach the legislative arena. But they also may not. Or when we mail our newsletter out, we often include job announcements or book announcements or conference announcements, along with the reports about critical issues that may reach the legislative arena.

When we publicize our research reports nationwide, we do it so that we can influence hundreds of thousands of decisionmakers in the world of private philanthropy, but at the same time these reports may be ultimately used by us or by others that we don't even know to affect legislation.

There are other examples in my testimony. I will skip those.

Cost-effectiveness for charities is very hard to achieve. We are under the gun from public, from contributors, and from our own imperatives. We also seek to do an honest job of reporting our lobbying expenditures versus our other expenditures. The Conable provision of the Tax Reform Act of 1976 was a great leap forward, moving away from the vague and arbitrary insubstantiality test of before. It really is difficult in some ways to comply with it, because it involves accounting hour by hour for what every staff person does, and it also means limiting one's lobbying and grassroots lobbying to levels that others need not respect. But the Conable provision is light years ahead of its insubstantiality test predecessor in providing clear guidance for legitimate lobbying.

Under the substantiality test, a charity could have its tax-exempt status lifted because, not only of arbitrary, but also of capricious or politically motivated IRS decisions, and that certainly has happened in the past. And then because the penalty was too high to pay, and the criteria for decisions vague, most charities were very timid about entering into the public policy arena. You were deprived of their research and analysis. The TRA of 1976 dramatically changed the situation. Henceforth, excessive lobbying would lead to penalty fines before any lifting of tax-exempt status was even considered, and the IRS decisions would be based on expenditures which are countable dollars and cents, as opposed to arbitrary, capricious, or politically motivated interpretations of criteria.

And as Sheldon Cohen indicated, organizations have elected to come under the Conable provision because they wanted to be sure. Sure means you can count. It doesn't mean you have to depend on reading somebody else's mind. So the issue of clearly defining limits for lobbying was resolved with the TRA of 1976, leaving in effect the issue of what constitutes proper accounting. Or at least that's what we had all thought prior to the IRS' issuing of recent regulations.

Finally, I will conclude by saying that if the committee is principally concerned with charities or foundations which appear to support political candidates, and much of the testimony and questions from you have seemed to indicate that, then I think there is an easy beginning response to this, which is to urge IRS—and to provide IRS with greater resources—to examine the potential cases of abuse in that area, because charitable support for political candidates is absolutely prohibited.

We have got a different situation, however, when we are talking about lobbying by charities. It was allowed prior to the TRA of 1976. It was expanded after that for smaller organizations. It's legitimately allowed right now, whether an organization lives under the insubstantiality test or the 501(h) test. These issues should not be confused, and I urge the committee to do everything possible to keep them separate.

Thank you.

[The prepared statement follows:]

National Committee for Responsive Philanthropy

Testimony
of
Robert O. Bothwell
Executive Director

National Committee for Responsive Philanthropy
March 13, 1987

before the

Subcommittee on Oversight
The Honorable J. J. Pickle, Chairman
Committee on Ways and Means
U.S. House of Representatives

The National Committee for Responsive Philanthropy is a public charity exempt from Federal Income Tax under Sections 501(c)(3), 509(a)(1) and 170 (b)(1)(A)(vi). We also have elected under Section 501(h) to come under the Conable provision of the Tax Reform Act of 1976.

The Committee was organized to pursue remedies to the closed doors in private philanthropy that deny information, access and funding to many charities.

We have sought to expand the information grantmakers provide to grantseekers, so that the latter may learn which of the tens of thousands of grantmaking foundations and corporations might be interested in funding their work.

We have sought to increase these grantseekers' access to United Ways, foundations and corporations, so that smaller, newer, or grassroots organizations may receive serious hearings of their proposals from real people connected to the decision-making processes of our major philanthropies.

We have helped organize joint fund raising appeals by local organizations frozen out of workplace fund raising drives, so they might independently raise payroll deduction contributions from willing employees.

And we have sought to open up the Combined Federal Campaign, to permit the many vibrant, newer charities of recent times to receive a share of the $140 million annually raised from federal employees.

These goals have not been achievable overnight. The people within philanthropy who keep the doors closed do so either out of ignorance of the benefits of open doors, or because they benefit too substantially from the status quo. Regardless, the valuable charitable impulses seeded in newer, smaller or grassroots organizations do not grow and ripen. Our society is often poorer as a result.

To combat the closed doors of private philanthropy our Committee has had to undertake research, publish reports and actively publicize the significant results. We've helped others do the same. Additionally, we publish monthly bulletins and a regular newsletter.

We've also gone into the field to help organize local organizations to undertake radically new joint fund raising efforts. We've advised them how to seek changes in state and city regulations and sometimes laws, as well as changes in corporate and United Way policies and practices.

We ourselves actively lobbied Congress in 1979-1980 to help open up access to the Combined Federal Campaign and then from 1982 to the present time to keep the CFC open.

Lobbying and grassroots lobbying are very important to our efforts to change private philanthropy and public policy affecting private philanthropy. But lobbying, however essential, is only part of our larger whole. Research, publicity, public education, conferences, technical assistance in the field and more are also integral to our efforts.

Our goals would be hard enough to accomplish even if we had an unlimited supply of money and volunteers. But that is far from the case. Our total income last year was but $331,000. Whatever new activity we choose to do, therefore, must be piggybacked onto other activities already underway, if we are to be cost-efficient spenders of our charitable dollars.

Our newsletter must always contain background information about critical philanthropic issues which may reach the legislative arena -- or may not -- at some future point. When we mail out our newsletter we sometimes include job, book or conference announcements, along with the reports on critical philanthropic issues. Our research reports are always actively publicized across the nation because we are trying to influence the hundreds of thousands of philanthropic decision-makers, but eventually the reports may be used by us -- or others -- to seek legislation. Our local field work is basically provision of technical assistance about more effective fund raising, but we certainly talk some about issues which currently are under legislative review, or which eventually may be. Our mailing list -- kept fanatically current -- is used for mailing monthly Bulletins of news articles on philanthropy, our newsletter, money solicitations, and action memos urging lobbying to be done. And the mailing list is selectively used every time, utilizing the efficiency of 182 different mailing code designations.

Cost effectiveness for charities is hard to achieve. We're under the gun from the public to achieve it, from our contributors, and from our own desire to get the most "bang from the buck". We also seek to do an honest job of reporting lobbying and grassroots lobbying expenditures, using acceptable methods of accounting.

The Conable provision of the Tax Reform Act of 1976 was a tremendous jump forward in moving away from the vague and arbitrary "insubstantiality" test for acceptable lobbying. It isn't necessarily easy to comply with the Tax Reform Act of 1976. It involves accounting for every hour spent every day, and limiting one's lobbying and grassroots lobbying to levels others need not respect. But the Conable provision is light years ahead of its "insubstantiality" test predecessor in providing clear guidance for legitimate lobbying.

In the interests of helping the Committee understand the Conable provision and our one organization's work within its admirable structure, we have provided to the Committee a full set of documents containing general information about our organization, a complete set of our current publications, detailed agendas of our most recent national conferences, and a complete set of our mailings to the field regarding our one and only major lobbying campaign in 1985-1986. We welcome your examination of these documents and your questions about the adequacy of the current law regarding lobbying by public charities.

Mr. FLIPPO. Thank you.

Mr. Blackburn.

STATEMENT OF JOSEPH W. BLACKBURN, COUNSEL, COALITION OF HEALTH SERVICES ORGANIZATIONS, BIRMINGHAM, AL

Mr. BLACKBURN. Thank you, Mr. Chairman.

My name is Joe Blackburn, and I represent a group of nonprofit health care providers. We are probably the most nonpolitical of any group that is here today, and our sole message, I can state very briefly, is that we are concerned, as Mr. Cohen stated this morning, that any effort to get the bad guys is going to wind up getting some of the good guys as well. We believe that current law is adequate to resolve potential problems and abuses that are believed to exist, or that are perceived.

We do commend this committee for its efforts in bringing more light to the issue, but believe that enforcement and added disclosure of—or added awareness of the problem will go a long way toward resolving the problem itself.

We also do not believe that the Internal Revenue Code would be the appropriate way to attack these problems. For example, the Federal election laws seem to have precipitated or certainly given a great deal of the incentive for many of the perceived abuses. Those laws would therefore be the more appropriate place to target some remedy.

Now I would also point out that I believe that most of the abuses that are alleged to take place with charitable or nonprofit organizations could as easily be accomplished with business deductions or by for-profit organizations, so that there is nothing unique about tax-exempt organizations in that regard.

For example, the availability of mailing lists, which can be prepared through costs that are business deductions, give effectively the same benefit and the same circumvention of the election laws to private business as to tax-exempt organizations. The same opportunity for issue research with deductible business expenses, would also provide the same benefits and the ability to circumvent those laws as a tax-exempt organization would have.

Therefore, it appears that revision of the code really should not be the way to approach the problem. If there is any shortcoming in existing law, it may lie in the penalties available under existing law. Certainly there are a lot of existing penalties available, and if it is known that they will be applied, both criminally and civilly, that certainly should go a long way toward ending abuses, and those remedies and penalties should be adequate.

In some situations, loss of tax-exempt status as a penalty would be too harsh a penalty and may result in lax administration of the law. For example, with a major denomination or very popular charity in the United States that crossed the line, loss of tax-exempt status may be too harsh and therefore result in lax administration by the Internal Revenue Service, or discriminatory administration by the Internal Revenue Service, and perhaps lesser penalties should be provided for that are not presently available in the law.

Beyond that, we would merely ask that Congress not inhibit the legitimate operation and function of tax-exempt organizations in an effort to reach possibly abusive practices of a relatively small group of tax-exempt organizations. We hope and believe that reliance on current law and enforcement procedures will resolve the problem.

Thank you.

[The prepared statement follows:]

STATEMENT OF JOSEPH W. BLACKBURN, PALMER PROFESSOR OF LAW, SAMFORD UNIVERSITY'S CUMBERLAND SCHOOL OF LAW; SCHOLAR IN RESIDENCE, SIROTE, PERMUTT, MC DERMOTT, SLEPIAN, FRIEND, FRIEDMAN, HELD & APOLINSKY, P.C.; ON BEHALF OF COALITION OF HEALTH CARE ORGANIZATIONS

ISSUE PAPER ON POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

I.

INTRODUCTION.

Section 501(c)(3) tax-exempt organizations must not only be organized exclusively for exempt purposes, but also must be "operated exclusively" for such purposes. Applicable Treasury regulations relax the "operated exclusively" requirement only slightly by providing that an organization will satisfy the test only if it engages primarily in exempt activites. Even these regulations clarify that "if more than an insubstantial part of [the organization's] activities is not in furtherance of an exempt purpose" that it will not satisfy the requirements of Code §501(c)(3).

These and other existing provisions of the Internal Revenue Code and the common law that has developed around them provides ample restraint on the political or other nonexempt activities of exempt §501(c)(3) organizations.

A legislative solution to recent, unpopular and unanticipated political use of §501(c)(3) organizations would constitute an overreaction. Existing laws and existing enforcement procedures have only now begun to focus on these possible abusive uses of exempt organization status. Furthermore, no legislative response could be so narrowly drafted as to insure that it would not impinge on the very important right of exempt organizations to continue with their legitimate functions.

For example, the currently proposed Treasury regulations reflect that the Internal Revenue Service believes that the only solution is a very "Draconian" solution that would "chop off" the heads of all tax-exempt organizations. The proposed Treasury regulations only strong point is that they would apply uniformly. In deed, there is no way to segregage the unpopular and potentially abusive use of exempt organizations from the more established and traditional operation of such organizations in a nondiscriminatory fashion.

The fact that a tax-exempt organization is a link in a chain leading toward a political or nonexempt goal does not in any way mean that the tax-exempt organization's activities are improper. Development and public dissemination of information dealing with the economic and public health threat arising from AIDS, "killer bees" from South America, or revolutions in Central America can all be legitimate tax-exempt activities.

I recommend relying on existing laws and existing systems for enforcement.

II.

EXISTING LAW.

A §501(c)(3) exempt organization receives the dual benefit of being exempt from federal income tax and having its contributions deductible by the contributor. In order to qualify for this special treatment there clearly should be restrictions on the activities of the organization. Requirements restricting such an organization's political activites presently exist as follows:

1. No substantial part of the activites of the organization may consist of carrying on propaganda or otherwise attempting to influence legislation, and

2. The organization is absolutely prohibited from participation or intervention in any political campaign on behalf of any candidate for public office.

Thus, any organization which is deemed to "participate in" or "intervene in" a political campaign on behalf of any candidate for public office will not qualify.

Note that attempts to influence legislation are not, as a result of mitigating regulations, an absolute prohibition. Although §501(c)(3) states that an exempt organization's activities must be "exclusively" tax-exempt, Treasury Regulation §1.501(c)(3)-1(c)(3) relaxes this prohibition by requiring merely that "no substantial part" of the activities may be devoted to nonexempt purposes. Thereafter, in 1976, the Internal Revenue Code was revised to establish more objective criteria to determine what was "substantial" and what was not "substantial".

Since the prohibition against participation or intervention in a political campaign is absolute, existing law merely requires the interpretation of what constitutes such participation or intervention.

Again, under existing law these terms have been broadly interpeted to include both direct and indirect participation. Although the Treasury regulations describe several specific types of activites which do constitute prohibited participation or intervention, the general rule is that all surrounding facts and circumstances, including the activities of the organization, are to be considered. Furthermore, the regulations clarify that the burden of proof is on the organization "to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interest."

The regulations also define approved tax-exempt purposes. For example, an organization will not be deemed "educational if its function is the mere presentation of unsupported opinion."

III.

AVAILABLE PENALTIES FOR ABUSE OF EXEMPT ORGANIZATION STATUS.

While there is substantial current law and enforcement procedures, perhaps the one element lacking from the enforcement procedures is an adequate penalty. The traditional penalty of mere loss of tax-exempt status, standing alone, would be insufficient. However, the Internal Revenue Code has very substantial civil fraud and criminal provisions. Abuse of its tax-exempt status by a §501(c)(3) organization ought to expose the organizors, the contributors and possibly other related persons to criminal prosecution. See, for example, §7201, §7206 and §7207 of the Internal Revenue Code. Certainly these sanctions could, if deemed necessary, be made more directly applicable to abusive use of tax-exempt organizations.

Additional civil penalties could be established under federal law. For example, persons "in control" of organizations which have applied for tax-exempt status and received tax deductible contributions should be viewed as holding those funds in trust for the public good. If tax-exempt status is lost due to a violation of the §501(c)(3) requirements, such persons could be held liable for violating the public trust and required to reimburse the corporation for all funds inproperly diverted. Thereafter, the cy pres doctrine could apply so that such funds would be placed with similar institutions. Similar remedies may presently be available in some states through suit by the Attorney General's office of the state or perhaps by "private attorney's general" if specifically allowed by state law.

Additional remedies and penalties exist under federal election laws. Certainly, use of a tax-exempt organization to circumvent federal election laws should be addressed in such federal election laws, not the Internal Revenue Code.

IV.

CONCLUSION.

Do not inhibit the legitimate operation and function of tax-exempt organizations in an effort to reach some possibly abusive practices of a relatively small group of tax-exempt organizations. Rely on current enforcement procedures, but consider utilizing a wider range of avaiable penalty provisions. Also consider expanding civil penalties for persons who abuse the public trust and waste dollars which were to be applied to the benefit of the general public.

Mr. **Flippo**. Thank you, Mr. Blackburn.
Mr. Lescault.

STATEMENT OF JAMES LESCAULT, EXECUTIVE DIRECTOR, URBAN EDUCATIONAL SYSTEMS, INC.

Mr. **Lescault**. Thank you. I am James Lescault. I am the executive director of Urban Educational Systems located in Jamaica Plain, Mass.

Urban Educational Systems is a private nonprofit organization based in, as I said, Jamaica Plain, with the principal purpose to assist in and advance arson prevention and neighborhood stabilization, incorporated in 1977 as a 501(c)(3).

UES is particularly concerned with addressing the causal factors related to arson with emphasis on development and dissemination of techniques and strategies to reduce the occurrence of arson.

Although I have submitted my full statement, I'd like to just excerpt a few things to highlight why I am even here.

I think what I am trying to demonstrate is those small community based nonprofit organizations and how they can influence at the Federal, State, and local level, major issues. Historically, this whole issue has been kind of controversial to say the least.

Back in 1974 to 1977, there was a group formed called the Symphony Tenants Organizing Project in Boston, because of a two street neighborhood in that particular part of town that had experienced 20 major fires resulting in 5 deaths, 13 boarded up buildings and 500 people being dislocated and displaced.

At that time, the tenants who approached the officials were told that they felt it was juveniles and therefore there was nothing you could do. This philosophy went over to the national level, that there is nothing you can do about arson, that it was a reactive thing. You had to catch someone with the match.

These particular tenants didn't believe that was the case. They felt something else was happening. They taught themselves to research property, to go out and to look at the public record, if you will. From the information they gathered, they approached the then attorney general in Massachusetts, Bellotti, who understood what they were saying and started looking at it more closely.

What happened 6 months after their initial investigations was 33 men were arrested. These included real estate, bankers, police and fire officials. It is now a notorious case which definitely proved these juveniles, if you will, were not juveniles at all and there was a profit motive, $2 million in fraudulent claims had been received.

It was at that time that some of the original organizers decided that if it was happening in Boston, how about other cities across the nation. At that point, Urban Educational Systems was incorporated, in 1977.

From that point on, I like to think that through testimony that was given in front of congressional boards and panels that were established here in Washington, that the United States Fire Administration became very active and proponents of the whole philosophy of what we call arson early warning systems, that it was a predictable thing and have taught in their academy.

Since that time, the country has continued to burn to the ground. In 1985, in suspicious and incendiary fires, it is estimated that we lost $1.67 billion. That is direct losses and not the indirect losses of lost jobs, lost property, lost revenues.

What we try to do is educate people to that fact, that this is a housing economic issue. It is not just a public safety issue.

The community groups that we have dealt with range in size and sophistication from one volunteer organization to an established organization that may be a $1 to $2 million development corporation, but all based in a particular neighborhood in the community. What those organizations have done and what we have helped them to do is to learn the issue from the perspective that I just gave you and to go and educate their elected officials at the state, local and Federal level. By so doing, we looked at the regulations and saw that most of the organizations were not going to be using any substantial amount of time or money. Most of them were doing exactly what anybody would do in the neighborhood. From that initial effort, in the last 3 years, we have had influence at the congressional level to establish new monies to the United States Fire Administration to fund such programs at the community level.

One example of the successfulness of this is $60,000 that came into particular community groups in Massachusetts last year, raised the level of attention at the State level to $275,000 at the Executive Office of Community Developments, to fund fire and arson prevention programs, which now has a bill in front of the House for $1.5 million to approach this. This is one State.

The Federal Government is spending $250,000 nationally. What I am trying to say, Mr. Chairman, is that from a little bit of effort from a community level, a lot of education went all the way up and is coming back down. If it is new federalism, so be it in this particular case. If it is development of public/private partnerships, then so be it. I like to believe that we are taking rhetoric and we are really moving on that. We are getting the insurance industry to look at their role in this particular issue.

In closing, what I would like to say is that I think the issue in front of you is many sided. I was very interested. I was unfortunately not down here yesterday to hear the testimony before the committee but I really believe that your task is very hard but you should not exclude those many groups out there that are really doing what is specifically what the laws were developed to provide that service.

There are those groups that continuously do their bake sales, continuously go door knock for a little contributions and aren't at the sophisticated level that a lot of the organizations you have heard today are.

I appreciate this opportunity.

[The prepared statement follows:]

STATEMENT BY

JAMES LESCAULT, EXECUTIVE DIRECTOR
URBAN EDUCATIONAL SYSTEMS, INC.
Jamaica Plain, Massachusetts

Before

HEARINGS BEFORE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U. S. HOUSE OF REPRESENTATIVES

March 13, 1987

My name is James Lescault, and I am the Executive Director of Urban Educational Systems, Inc. (UES).

UES is a private, nonprofit organization based in Jamaica Plain, Massachusetts with the principal purpose to assist in and advance arson prevention and neighborhood stabilization. Incorporated in 1977 as a 501(c)(3), UES is particularly concerned with addressing the causal factors related to arson, with an emphasis on the development and dissemination of techniques and strategies to reduce the occurrence of arson.

Urban Educational Systems is unique in that its emphasis and capability spans the whole spectrum of arson prevention efforts, from basic research on arson to the development and implementation of arson prevention programs and the provision of technical assistance services. UES is also unique in that its geographic area of service is both national and local in scope: it has developed arson data systems that have nationwide applications, yet it provides technical assistance services to the smallest organizations.

I will attempt to demonstrate to this committee today an example of grassroots ingenuity and perseverance that has successfully altered previously-held beliefs and their subsequent programmatic responses at the federal, state, and local levels. The efforts that have been undertaken include presentations, reports, and personal interaction with elected officials, concerning a problem embodied in the realm of public safety, arson and fire, and enlightening those officials to the analytical assessment of the problem as being an economic one adversely impacting the country as a whole. These organizations, many 501(c)(3)s, have promoted a proactive prevention philosophy through the advocacy for structural changes.

Historical Review of Community Involvement in Arson/Fire Prevention

To help demonstrate the role community-based organizations are playing in the creation of arson/fire prevention partnerships, a quick review of their involvement in the issue is essential. Although there are a variety of community-based efforts in arson/fire prevention that could be singled out, the one that has attracted the most attention is in Boston, Massachusetts.

From 1974 to 1977, there were 20 major fires on two streets in the Fenway neighborhood of Boston. These fires resulted in five deaths, 13 boarded-up and abandoned buildings, three buildings becoming empty lots and 500 people forced to fine new homes.

After a fire killed a young boy in 1976, community residents formed the Symphony Tenants Organizing Project (STOP). The primary goal of STOP was to bring an end to the arson terror that was eliminating their housing stock and endangering their lives.

It was then the general opinion of local officials that juveniles were responsible for these fires. These officials also felt helpless because they believed that you could convict someone of arson only if you caught them with the lit match in their hand.

STOP members refused to believe that children with matches systematically were burning down their neighborhood. This disbelief was compounded by STOP's disagreement with the fire service's response which was reactive, occurring only after a fire. STOP believed that a more proactive/preventive approach was needed and set about to develop such a program.

The reactive philosophy of the local officials was not confined to Boston, but rather was a commonly held belief of fire service and law enforcement agencies nationally. There existed great doubt among these sectors about the proactive method that predicted where arson fires were likely to occur. STOP organizers disagreed and taught themselves how to conduct property research, including how to obtain public information on code violations, tax arrearages and insurance coverage, among other things. They then targeted the ownership patterns of the previously burned properties and publicly pointed out the most fire-prone owners.

The fires ended after six months of STOP's activities. At the end of a second six-month period, 33 men were arrested for arson and related crimes in Boston and surrounding towns. Boston was shocked to learn that arson-for-profit had infected dozens of neighborhoods outside of the now notorious Fenway.

The perpetrators of these crimes were not the juveniles officials first had thought, but rather once-respected lawyers, real estate developers, and policy and fire personnel. This group of loosely linked conspirators had killed three people, displaced another 500 ad received more than two million dollars in fraudulent insurance claims. The decision to conduct the costly and necessary investigation that resulted in the arrests was made by Massachusetts Attorney General Francis X. Bellotti, in great part based on the information provided by STOP.

In 1981, Urban Educational Systems, a successor organization to STOP, was designated by the Massachusetts attorney general's office to administer a program called the Comprehensive Arson Prevention and Enforcement System (CAPES). UES's role was to coordinate and assist community researchers in three arson- and fire-prone neighborhoods in Boston.

The neighborhoods that these community-based researchers conducted their investigations in experienced a 37 percent reduction in significant fires, while the major fires in all of Boston increased by 17 percent within the same time period. In a relatively short period of time, this preventive methodology based upon the use of predictable variables, also referred to as arson early warning systems (AEWS), became the state-of-the-art in arson investigation and, more importantly, prevention strategies.

A National Crisis

UES having been successful in promoting and institutionalizing a new model in preventive strategies, at the federal level, proceeded to reach out and provide technical assistance to other community-based organizations by securing financial assistance from foundations. A portion of our technical assistance was dedicated to enlightening these organizations and their funding sources with the section 501(h) portion of the 1976 Tax Act, stressing how these organizations were entitled to lobby for their constituents and communities.

With this enabling legislation, many tax-exempt organizations pursued the issue of arson and fire through their local, state and federal legislative bodies. This was a nonpartisan issue that the organizations felt was not receiving sufficient notice but was devastating their particular neighborhoods and the country as a whole. For example, in 1985, incendiary and suspicious fires in structures across the United States accounted for $1.67 billion, or one of every four dollars lost last year in structured fires. This arson problem, according to a report by the National Fire Protection Association (NFPA), constitutes the largest single cause of property damage due to fire in the U.S. Incendiary and suspicious structure fires and associated deaths and property losses all increased in 1985.

These estimated direct losses do not include indirect property damages such as loss of housing stock, jobs, tax revenue, replacement or reconstruction costs, higher insurance rates. As importantly, they do not include the amount of financial/revenue spending at the federal, state and local level to provide assistance to the victims of fires, whether it be temporary shelters, homeless shelters, public housing assistance, etc. The point is that arson and fire were and are a systemic problem to many of the housing and economic assistance programs.

Many of these community-based organizations (CBOs) came to Washington, D.C. and explained to their Congressional Representatives how this problem was affecting their districts. To the credit of both the community representatives and their legislators new programs were funded through the United States Fire Administration, specifically earmarked for nonfire service CBOs, performing anti-arson and fire prevention programming.

These programs have reached out actively to their fire departments to ensure coordination of their prevention efforts. They are attempting to establish long-range action plans with corresponding guidelines and definitions of protocol between the various agencies involved. They have leveraged additional funds, secured the involvement of other agencies and sectors, and used public education and awareness to mobilize broad-based support for arson/fire prevention legislation and adequate funding levels.

These CBOs vary in size from totally volunteer to extensively staffed organizations. Although these organizations address issues ranging from housing and economic issues to public education and advocacy, their philosophy concerning arson and fire is rooted firmly in preventive strategies. Their success lies in their ability to forge new alliances with the local, state and national fire service agencies, and their willingness to incorporate neighborhood stability and community development into public safety issues.

They accomplished these objectives by the use of the political process, especially during budgetary hearings and legislative mandates, and by their ability to develop broad-based support through the establishment of networks in the public and private sectors.

The major benefit of these local public/private partnerships in arson and fire prevention is that they provide strong and sustained leadership in prevention. One of the results of this leadership is the increase in the numbers and scope of activities of agencies, sectors and organizations involved in prevention activities. This includes the fire service, community-based organizations, educational systems, the insurance industry, governmental agencies and service organizations, among others.

These partnerships attempt to ensure that adequate levels of public and private funding are allocated to fire and arson prevention.

One good example of how these groups are able to mobilize new support and develop sufficient financial resources is presently occurring in the State of Massachusetts.

Last year $60,000 from the United States Fire Administration's program for anti-arson went to five CBOs in Massachusetts. These organizations had shown the state's Executive Office of Communities and Development the inherent connection between prevention intervention and redevelopment progress, resulting in the establishment of a $275,000 program. Presently, the chairman of the House Committee on Housing and Urban Development is sponsoring a bill on behalf of these organizations to establish a comprehensive Act Creating an Arson and Fire Prevention Program that unifies many of the various disciplines that are involved or impacted by the problem. This piece of legislation will provide $1.5 million this effort.

All of this momentum and positive potential is the result of grassroots organizations, many 501(c)(3)s educating their legislators to a local/national issue. I dare say without that interaction and subsequent demonstration, the 1985 figures would have been even higher.

Conclusion

Though the task before this committee -- the review of the lobbying and political activities of tax-exempt organizations -- is a complex and many-sided issue, I would like to leave with you this example of the positive role that community-based 501(c)(3)s have in the past and are presently performing on behalf of their own constituents and neighborhoods which benefit the greater whole -- the nation. This is only one particular issue, fire and arson, but it is exemplary of the type of approach and process many creative and dedicated individuals are using in attempts to facilitate and implement a truly democratic system open to new ideas and connected to the neighborhoods across the country.

That concludes my written presentation and I thank you for this opportunity to address this committee on such an important topic.

Mr. FLIPPO. Thank you very much.

Mr. Bothwell, I understand that you currently serve on IRS's Form 990 Advisory Committee. Are you satisfied that the form provides adequate public disclosure in this particular area? What do you think should be done?

Mr. BOTHWELL. Quite honestly, Mr. Chairman, I would say that we haven't looked at it with the focus of these hearings. I certainly would hope that we have a chance to do that very soon. The Form 990 Committee was formed about 3 years ago. We have examined other aspects of 990's. It is a good working group of some nonprofit organizations and experts along with the IRS people that can go far in examining these issues and making recommendations of changes. I hope the advisory committee can do it with your urging.

Mr. FLIPPO. Thank you.

Mr. SCHULZE. May I ask a question on that point?

Mr. FLIPPO. Of course.

Mr. SCHULZE. In correspondence with the district director in Philadelphia, he told me there were errors on about 85 percent of the form 990's. Has that information filtered back to the committee or were you aware of that kind of an error rate?

Mr. BOTHWELL. Well, let's put it this way, Mr. Schulze. Several years ago we did an examination of private foundation 990 returns, which is just one segment of all 990's. We did a fairly extensive examination that showed there were not only a lot of errors but a lot of blanks, a lot of information that should have been provided, that was required and was not provided at all. The GAO then reviewed our study, undertook a similar study and eventually corroborated and enlarged upon our findings.

I think when that was then presented in a congressional hearing, the IRS indicated, yes, that they thought that was the case, that they had been lax in monitoring 990's. They also admitted they had been short handed in monitoring 990's and that they would henceforth be looking at them more carefully. I think their intention has been good in that respect and would be good in looking at all 990's.

But let's face the reality. I think Mr. Cohen said it very well. The IRS is an organization designed to raise revenue, and exempt activities don't raise revenue. Therefore, the exempt section has always been short handed for any kind of monitoring.

We have a problem; we don't know what is out there. We see a few cases of abuse. We tend to think they are more prevalent. But we also know—I know from working literally with thousands of local charities—we know that very few of them would be coming close to passing the line on lobbying. Most of them don't come near it.

The IRS, I think, would like to do a better job, and has found itself short handed and not able to do a better monitoring job.

Mr. FLIPPO. More resources.

Mr. Lescault, you quoted an outstanding example of how society benefits from your organization. You are a 501(c)(3). Why aren't you a 501(c)(4)? A social welfare organization can lobby without restrictions. Why did you go 501(c)(3)?

Mr. LESCAULT. Well, Mr. Chairman, that is a good question. The minutes and discussion with my board of directors show that was a discussion of a few years ago. The majority of our money comes in to provide direct technical assistance to community groups or to a State government, let's say. We are a very, very small organization. My operating budget right now is $38,000. I am not a large organization. I have part time consultants that I hire.

Therefore, I do not fit under that level. I do not fit under any substantial amount of time in lobbying. We felt it was not our particular need.

Mr. FLIPPO. Mr. Blackburn, your organization, you pointed out, does not engage in any political activity. Is there any tandem organizations in which yours is affiliated with?

Mr. BLACKBURN. No. I didn't mean to say we do not engage in any political activity. We do not directly engage in any political campaigns. We do on occasion approach a Congressman and others in the Congress and the Senate on issues that do pertain to our charitable mission, but only in that narrow sense.

Mr. FLIPPO. Lobbying as opposed to political campaigns?

Mr. BLACKBURN. That's correct. We are not affiliated with any other (c)(4) group. We are nonpolitical. We are just concerned with getting shot in the fray between Congress and such other groups.

Mr. FLIPPO. You want to carry out the function that you were formed for?

Mr. BLACKBURN. Exactly.

Mr. FLIPPO. Mr. Schulze.

Mr. SCHULZE. Thank you, Mr. Chairman. I would also like to thank this panel. Your testimony has been very interesting.

Mr. Bothwell, you mentioned cost effectiveness. Do you want to elaborate a little bit? Should we use that as a criteria? It seems to me that Mr. Stark last year or sometime in the past put in a bill that said 50 percent of the money that a charity raised, must be used for the ultimate recipient or beneficiary.

Is cost-effectiveness a yard stick and is it a good one and how would you use it?

Mr. BOTHWELL. Yes, cost effectiveness is a good yardstick, but I would hate to see you try and legislate it. As an organization that in this town is not small, but on the other hand is far from large, I can tell you that we look three times at how to spend every single dollar. The salaries we pay are way below the Federal Government level of salaries for people with appropriate experience and certainly below the private corporation level. We pay lower salaries as a matter of cost effectiveness.

When we put out a report, we seek free nationwide publicity on it, because even if we wanted to advertise, we don't have the money to seek that advertising.

I think the thing I was trying to indicate also is that every aspect of what one does as a nonprofit, whether large or small, is to piggyback all kinds of different things together as a way of trying to save money.

Let me give you one simple little example. We send out a newsletter. The postage on the newsletter covers the cost of mailing the newsletter. For a cost of maybe 2 cents a piece, I can insert a job announcement or a book announcement or a conference announcement. The postage cost won't increase. My handling cost will only be 2 cents a piece. It would be foolish of me to try and mail that stuff out separately when I can piggyback it. You multiply that in

10 different ways and you end up with a very complicated way of operating, because you are trying to be cost effective.

I don't think you can legislate cost effectiveness.

Mr. SCHULZE. Can we say an organization which consumes 95 percent of the amounts raised, in raising those funds is not cost effective? Could we say 85 percent? 80? 60? 40? Is there any kind of criteria?

Mr. BOTHWELL. I mean, when you put it that way, I would look foolish to say that 95 percent expenses was being cost efficient.

Mr. SCHULZE. I can understand the first year.

Mr. BOTHWELL. Let me give you an example of a serious problem concerning how we raise money. If I am the United Way and I have major corporations in this country doing all of my soliciting for me, my fund raising costs are going to be limited to 10 or 15 percent of the total raised, because I've got all that corporate manpower and womenpower doing it. On the other hand, if I am a brandnew charity just starting out, dealing with an unpopular cause, and I have to raise money through the mail, my cost during the first 3 years could be anywhere between 50 and 100 percent of the revenues raised, and that would be legitimate in the nonprofit world scheme of things, because after some point in time, if our cause had merit, it would become more acceptable to the public, we would attract free help as the United Way does, and our costs would come down.

It's terribly complicated. I've been sitting on a task force of private charities that has involved some 50 to 100 people over the last 3 years and they have been communicating with representatives from the National Association of Attorneys General, wrestling with how to come up with a model bill dealing with charitable solicitation.

I can't say they all came to some agreement. They came to some tentative compromises, which is not necessarily agreement.

Mr. SCHULZE. You are right, this is not an area where we have black and white solutions, much of this has to depend upon the good will involved. I must say that I especially agree with your remarks about the Conable amendment. I believe that was the direction to go in, and hope that we can continue that.

Mr. Blackburn, you said that business deductions could also be used to generate mailing lists, but I'm not aware of any businesses which would generate a mailing list which could then be utilized in a political manner, which has been referred to as an abuse in these hearings.

Are you aware of——

Mr. BLACKBURN. I'm not aware of abuses, Congressman Schulze. I was pointing out whether it be mailing lists or money spent for issue research, perhaps issue research on the trade imbalance, the foreign trade imbalance, that businesses could get a deduction whether they contributed to a 501(c)(3) organization which engaged in that effort or whether they undertook the research themselves and fashioned it as a business deduction, they would receive that deduction. They could then, and I'm not aware of too many advertisements, but I know, for example, the UAW right now is having public television advertisements on trade imbalance issues, the W.R. Grace Co. had advertisements on the federal budget deficit.

Certainly, various media could be utilized thereafter to timely bring those issues and the results of that research to the attention of the public in the same fashion as 501(c)(3) organizations.

All I'm trying to say in that issue is not that there's some big abuse there; I'm saying the potential lies both ways, that the real problem, perhaps, is in the Federal election, the Federal campaign laws and not more in the Internal Revenue Code. We are trying to restrict those sorts of activities, and restricting it in that more precise area than go after just tax-exempt organizations.

Mr. SCHULZE. Thank you, Mr. Blackburn.

Mr. Lescault, it seems to me that the insurance companies would be bending over backwards to give you large amounts of money; you've been one of their great benefactors. This is not true?

Mr. LESCAULT. It is not true. As a matter of fact, I was invited 2 years ago to testify in front of Chairman Walgren's committee across the hall on authorization, and one of the representatives didn't like that kind of question that I answered. I didn't bring it up, I was asked the question.

That's the structural change that I addressed and tried to address.

Mr. SCHULZE. Any reason for that? You know, it just seems, from your testimony, I would think it would be a logical sequence that they would say these people are in the long run doing a great service for us, how can we help them.

Mr. LESCAULT. It's one of those amazing questions of this century, I think. The insurance industry, when we do approach them, and we have written grants to every major insurance company, and to date we've received $5,000.

Mr. SCHULZE. Do they have a program of their own or any kind of a program?

Mr. LESCAULT. Well, they set up Insurance Committee, Arson Control which is a shared panel from many of the companies who put out a newsletter. They do not—they did fund a program in conjunction, I'll give them credit, the Arson Information Management Systems called AIMS, Ford Foundation put up $400,000, they put up $40,000. But the point that I'm trying to make is, they're a business. They're—the way we try to explain them is, they're a bank, and when the interest rates are high, they're out there and they'll underwrite anything, business, and when it's down they do draw a line.

What we try to do is get accountability through what we call the two-tier application, which is a tickler, if a person has had a fire then you go into more depth. We've instituted that in a number of states. But we've put up municipal tax lien bills where, if there's a fire in a city the insurance company is supposed to contact the municipal government to make sure there's no arrears, and they pay directly there; that's one less incentive for arson for profit. But we have had a long struggle with that industry. And there is, of course, in the McCarran-Ferguson Act that's continually brought up, I believe, Metzenbaum has a bill presently on that.

It's just one of those perplexing things that, they don't want to spend the money on the underwriting. They don't want to spend the money on closer scrutiny and going out; they're rather—and also, on the investigation end, the reactive end, as we call it.

So, we're really in a strange fix there, to answer your question in a roundabout way.

Mr. **Schulze**. That's very interesting.

I thank the panel for their contribution.

Thank you, Mr. Chairman.

Mr. **Flippo**. Thank you.

I just wanted one last question to pose to the panel, if any of them would care to react. Is it possible that a corporation could make a tax deductible contribution to a 501(c)(3) involved in educational activities, and that 501—and including polling data to ascertain the public's thoughts about a given subject; and that 501(c)(3) be affiliated with a 501(c)(4) to engage in political activity at the present time? Does any of the members of the panel feel that that is an inappropriate use of the vehicle, since I know that the fact, we've had some testimony here that a 501(c)(3), even though it's link in a chain should not be penalized because of its purposes, is that—do you think that's a description of what may be going on out there, and do you think it's an appropriate vehicle to take place? Any reaction from the panel?

Mr. **Bothwell**. Just a quick reaction, Mr. Chairman. I don't see anything wrong with the corporation giving the tax deductible money to the 501(c)(3) to do the polling on certain issues. It falls within our understanding of what the law allows.

The issue, it seems, is this tight relationship between (c)(3)'s and (c)(4)'s that perhaps need a lot more examination. We don't have a (c)(4); I, therefore, cannot speak to that. But I've heard a lot of today's testimony that addresses this issue, and it seems there's a lot of ignorance as to just what are the problems, as well as what are the solutions.

Mr. **Flippo**. Any other member care to react?

Mr. **Blackburn**. Just briefly. In my written testimony I used two examples; one, they're not intended to be flippant, but with killer bees coming out of South America, you certainly could have a (c)(3) organization established to study the impact that they may have on the health and economy of the United States. Thereafter, a (c)(4) organization affiliated or unaffiliated might take that research result and try to get legislation passed to—through the Department of Agriculture to control killer bees.

If another organization undertakes research to determine the impact on the economy from the revolution in Nicaragua. And some other organization goes further, (c)(4). You're not going to be able to distinguish between those two. And they both are educational, and they both are (c)(3) organizations who serve that function. And there is nothing wrong with their being utilized as a link in the chain.

Mr. **Flippo**. Well, I thank the witnesses for their testimony, and we think all of the—want to thank all of the witnesses yesterday and today as well. It has been very helpful to clearly disclose that there are many and varied activities in this field. The matter raises great questions.

We appreciate your contribution to helping us wrestle with this problem. Thank you very much.

The committee is adjourned.

[Whereupon, at 12:06 p.m., the hearing was adjourned.]

APPENDIX

APPENDIX A. CONGRESSIONAL RESEARCH SERVICE REPORT

Congressional Research Service
The Library of Congress

Washington, D.C. 20540

TAX-EXEMPT ORGANIZATIONS:
LOBBYING AND POLITICAL ACTIVITY

Robert B. Burdette
Marie B. Morris
Thomas B. Ripy
Legislative Attorneys
American Law Division
March 10, 1987

Executive Summary

This report consists of two parts. Part I discusses the historical development of the law governing lobbying and political activities by tax-exempt organizations. The first statutory limits on lobbying were enacted in 1934 and the first such limits on political activity in 1954. The history, past and present, suggests certain repetitive themes. First, calls for examination of legal limits in the area generally follow some publicized legislative or political actions by organizations that are funded by tax deductible contributions. Questions are raised concerning the propriety of such conduct. Second, when precise limits are discussed the problem of drawing lines which do not unduly limit speech and association or education arise. Third, even though the drawing of lines is difficult there seems to be general agreement that the government does not have to, nor should it, permit charitable organizations funded by deductible contributions to become lobbying or political organizations. Part II of the report provides an abstract examination of the limits of current law and tactics for maximizing freedom from statutory limits that tax-exempts might consider. Collectively, they provide an historical and legal overview of the current controversies surrounding this area of the law.

PART I
LIMITS ON LOBBYING AND POLITICAL ACTIVITY BY TAX-EXEMPT ORGANIZATIONS: HISTORICAL BACKGROUND AND CONTINUING ISSUES

Marie B. Morris
Thomas B. Ripy
Legislative Attorneys
American Law Division
March 10, 1987

INTRODUCTION

Section 501(c)(3) of the Internal Revenue Code allows a tax exemption for charitable organizations only where "no substantial part of the activities ... is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in subsection (h)),[1] and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office." Identical restrictions on legislative and political activity are contained in the provisions of the Code permitting charitable deductions from income,[2] estate,[3] and gift taxes.[4] Private foundations are subject to special excise taxes on prohibited expenditures for lobbying or political activity, though they may spend money in nonpartisan, widespread voter registration efforts.[5] The most stringent tax code limits on lobbying and political activity are those imposed upon 501(c)(3) public charities and private foundations. Other tax exempt organizations are subject to less stringent, or in certain cases, no real limits. Thus, for example, a tax-exempt 501(c)(4) social welfare organization may engage in lobbying activities[6] and a section 527 tax-exempt political organization is expected to engage in political activities.[7]

---

[1] Section 501(h) provides an elective standard for determining what is a substantial portion of the activities of a 501(c)(3) public charitable organization. The limit is defined in terms of the amount of expenditures to influence legislation. Private foundations cannot make the election.

[2] I.R.C. Sec. 170(c)(2)(D).

[3] I.R.C. Secs. 2055(a)(2) and 2106(a)(2)(A)(ii).

[4] I.R.C. Sec. 2522(a)(2).

[5] I.R.C. Sec. 4945 public charities are also subject to tax on excessive lobbying expenditures under I.R.C. Secs. 4911 after a 511(h) election.

Just as the tax code provides different limits on permissible lobbying and political activities by various types of exempt organizations, so is different income tax treatment accorded contributions and dues payments to such organizations. Contributions to 501(c)(3) public charities and private foundations are generally tax deductible as charitable contributions under I.R.C. Sec. 170. Contributions to a 501(c)(4) social welfare organization, a 501(c)(5) labor union, or a 501(c)(6) business league are not, nor are contributions to political organizations.[8]

The purpose of this report is to provide an overview of the historical development of the statutory law governing lobbying and political activities of tax exempt organizations, hopefully providing some understanding of the reasons for the differences in tax treatment of various types of tax-exempt organizations and the continuing legal and policy concerns.

---

[6] Such an organization may be created and operated for the purpose of informing the public on controversial issues and may advocate particular views and changes in law. See, e.g., Rev. Rul. 68-656, 1968-2 C.B. 216. The ability of the (c)(4) social welfare organization to lobby without adverse tax consequences was explored at some length in Regan v. Taxation with Representation 461 U.S. 540 (1983). Similar treatment is accorded 501(c)(5) labor unions, 501(c)(6) business associations, and 501(c)(a) veterans organizations.

[7] For more detailed background information on section 527 exempt political organizations see CRS Report, Tax Treatment of Political Organizations and of Tax Exempt Organizations Engaged in Political Activities, Thomas M. Durbin (May 26, 1982) and CRS Report 81-192A, Federal Tax Law of Special Interest to Participants in Political Campaigns, Robert B. Burdette (revised August 5, 1981). Section 527 of the Internal Revenue Code was enacted in 1975 (P.L. 93-625, 88 Stat. 2116). It was intended to clarify the tax treatment of political organizations, including political action committees (PACs). Such organizations are not taxed on their exempt function income and gifts to such organizations are not subject to a gift tax.

[8] Dues to a business association or union may be deductible as an ordinary and necessary business expense under I.R.C. Sec. 162. Contributions or dues to political organizations are not.

HISTORY

REVENUE ACT OF 1934: LEGISLATIVE ACTIVITY

The first legislation enacted in this area was contained in the Revenue Act of 1934,[9] which included a provision prohibiting deductions for contributions to 501(c)(3) type organizations where a "substantial part of the activities [of the organization] is carrying on propaganda, or otherwise attempting, to influence legislation." The amendment was recommended by the Senate Finance Committee[10] and added on the Senate floor.[11] As recommended by the Senate Finance Committee and adopted originally by the Senate, the language of the prohibition also extended to "participation in partisan politics." That language was removed in conference so that the final limit was directed toward lobbying activities.[12] As the excerpts from the floor debate reproduced below suggest, there was apparently a two-fold policy concern. First, it seems that the sponsors believed that some organizations were engaged in lobbying campaigns using tax deductible contributions and that this was inappropriate (not charitable) behavior. Second, the debate reflects concern over how language could be drafted to permit what was seen as appropriate activity (presumably viewed as educational) while limiting excesses. Drawing that line was difficult then, and it continues to pose a legal and policy dilemma.

---

[9] Revenue Act of 1934, Sec. 517, 48 Stat. 760.

[10] S.Rep. No. 558, 73d Cong., 2d Sess. at 26.

[11] 78 Cong. Rec. 5959.

[12] H.R. Rep. No. 1385, 73d Cong. 2d Sess. at 17.

(78 Cong. Rec. 5861)

The next amendment of the Committee on Finance was, on page 25, line 7, after the word "individual", to insert a comma and "and no substantial part of the activities of which is participation in partisan politics or is carrying on propaganda, or otherwise attempting, to influence legislation", so as to read:

> (o) Charitable and other contributions: In the case of an individual, contributions or gifts made within the taxable year to or for the use of:
>
> (1) The United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;
>
> (2) A corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is participation in partisan politics or is carrying on propaganda, or otherwise attempting to influence legislation.

Mr. REED. Mr. President, as that amendment is worded, it would apply to the Society for the Prevention of Cruelty to Children, to the Society for the Prevention of Cruelty to Animals, or any of the worthy institutions that we do not in the slightest mean to affect.

Mr. HARRISON. Mr. President, will the Senator yield for a moment?

Mr. REED. Certainly.

Mr. HARRISON. In considering that amendment, as I recall, the sentiment of the committee was that the provision should apply to any organization that is receiving contributions, the proceeds of which are to be used for propaganda purposes or to try to influence legislation.

I called the attention of the experts to the fact that it seemed to me the proviso at the end of the second paragraph should apply to all four paragraphs. Of course, that would affect some war organizations, but personally I see no difference between one organization that might be on one side of the fence getting contributions to propagandize and influence legislation and being permitted to proceed without interference, while at the same time preventing one that might have a different viewpoint from receiving or making use of contributions for the same purpose.

Mr. REED. I have no objection whatever and no disagreement with the Senator in regard to what we were trying to do by this amendment. There is no reason in the world why a contribution made to the National Economy

League should be deductible as if it were a charitable contribution if it is a selfish one made to advance the personal interests of the giver of the money. That is what the committee were trying to reach; but we found great difficulty in phrasing the amendment. I do not reproach the draftsmen. I think we gave them an impossible task; but this amendment goes much further than the committee intended to go.

Mr. COUZENS. Mr. President, will the Senator yield?

The PRESIDING OFFICER. Does the Senator from Pennsylvania yield to the Senator from Michigan?

Mr. REED. I do.

Mr. COUZENS. Does not the Senator believe that the words " substantial part " will exclude the tuberculosis societies and the children's welfare societies? Certainly a substantial part of their income is not devoted to propagandizing for legislation.

Mr. REED. I am not so sure. Take the case of those who are urging the adoption of the child-labor amendment: Certainly they are not acting from selfish motives, and yet almost their entire activity is an effort to influence legislation.

Mr. HARRISON. May I ask the Senator whether he does not think it would be wise to pass over this amendment for the present?

Mr. REED. Perhaps that would be better.

Mr. HARRISON. Really, I think it ought to be inserted at another place in the bill.

Mr. REED. I do not want to take too much time in discussing it.

The PRESIDING OFFICER. Without objection, the amendment will be passed over.

The reading of the bill was resumed.

• • •

(78 Cong. Rec. 5959)

The next amendment passed over was, on page 25, line 7, after the word " individual ", to insert a comma and " and no substantial part of the activities of which is participation in partisan politics or is carrying on propaganda, or otherwise attempting to influence legislation ", so as to read:

> (o) Charitable and other contributions: In the case of an individual, contributions or gifts made within the taxable year to or for the use of:
>
> (1) The United States, any State, Territory, or any political subdivision thereof, or the District of Columbia, for exclusively public purposes;
>
> (2) A corporation, or trust, or community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is participation in partisan politics or is carrying on propaganda, or otherwise attempting to influence legislation.

The VICE PRESIDENT. The question is on agreeing to the amendment.

Mr. COUZENS. Mr. President, I hope this amendment will be agreed to. Then it can go to conference, and we can change the language if it is found to do any inequity.

Mr. HARRISON. I may say to the Senate that the attention of the Senate committee was called to the fact that there are certain organizations which are receiving contributions in order to influence legislation and carry on propaganda. The committee thought there ought to be an amendment which would stop that, so that is why we have put this amendment in the bill.

> Mr. REED. Mr. President, I do not think the committee is proud of the language in which this amendment is couched. I know that the legislative drafting counsel who drew it expressed no pride whatever in their product; but I agree with the Senator from Michigan that if the amendment shall be agreed to we will have from now until the conference to study the subject and prepare better phraseology.
>
> Mr. LA FOLLETTE. Mr. President, I desire to add just a word to what has been said about this amendment.
>
> In my opinion, we shall never get away from abuses or mistakes of administration so far as contributions to organizations of this character are concerned until all contributors are deprived of exemption from the payment of income tax on contributions made to these organizations.
>
> I recognize, as the Senator from Pennsylvania [Mr. REED] said the other day when this matter was up, that there are certain types of organizations to which Congress and the executive branch of the Government might desire to encourage contributions. It is difficult from the administrative point of view for those in the Internal Revenue Bureau to determine when an organization is carrying on a type of activity which ought to be encouraged, and when it is carrying on a propaganda type of activity. In my opinion, it will not make a penny's worth of difference, so far as the contributions to these various organizations are concerned, if they are all excluded from this immunity and all treated alike. It is my judgment that we never shall get away from mistakes of administration and from decisions which may seem like favoritism until all contributions to organizations of this kind are made subject to the income tax.
>
> The VICE PRESIDENT. The question is on agreeing to the amendment.
>
> The amendment was agreed to.

While the legislative history is sparse and does not clearly establish the congressional rationale in the enactment of the provision, the thrust of the limitation seems consistent with the pre-1934 position of the Internal Revenue Service that legislative activity was not a tax exempt charitable purpose.[13] It may also be to some extent a reflection of the views expressed by Judge Learned Hand in Slee v. Commissioner[14] some four years earlier. There the court upheld a decision of the United States Board of Tax Appeals disallowing a charitable deduction for contributions to the American Birth Control League. While acknowledging that a charity may seek to influence legislation and still retain its charitable character (for example a university seeking an appropriation, an organization seeking a special charter, or a society to prevent cruelty to children seeking positive support of law to achieve its ends), Judge Hand found such activity legitimately consistent with the appellation charitable only where the legislative activity is "ancillary to the end in chief." Where enactment or repeal of legislation has become a primary purpose, however, the organization no longer exclusively operated for a charitable purpose, and Congress did not intend for the charitable deduction to be used to assist such activities. An examination of Judge Hand's opinion reveals the same difficult struggle in drawing lines between charitable, educational, and lobbying activities in this judicial decision that Congress faced four years later in examining statutory language.

---

[13] T.D. 704, 3 C.B. 240 (1920); S. 1362, 2 C.B. 152, 154 (1920).

[14] 42 F.2d 184 (2d Cir. 1930).

INTERNAL REVENUE CODE OF 1954: POLITICAL ACTIVITY

As noted above, the Senate had approved language limiting political activity in 1934. That language was eliminated in conference. In 1954, while H.R. 8300 (83d Cong.)(1954 I.R.C.) was under consideration on the Senate floor, Senator Lyndon B. Johnson offered an amendment to Sec. 501(c)(3) effectively denying tax exempt status to organizations intervening in campaigns on behalf of candidates. The amendment was accepted without debate or discussion.[15] No corresponding changes were made in the provisions governing deductions. However, in 1958 regulations were adopted under Sec. 170 expressly denying an income tax deduction for contributions to an organization participating or intervening in a political campaign on behalf of any candidate.[16] As noted below, the statutory language was itself modified to include this limit as part of the Tax Reform Act of 1969.[17] While the legislative history is silent, one secondary source indicates that Senator Johnson may have been motivated by a belief that a private foundation had provided some indirect financial support for an election opponent.[18]

---

[15] 100 Cong. Rec. 9604; the discussion in the debate and Conference Report (H.R, Rep. No. 2543, 83d Cong., 2d Sess.) simply describe the amendment in capsule form.

[16] T.D. 6285, 1958-1 C.B. 127.

[17] P.L. 91-172, Sec. 201(a)(1)(B), 83 Stat. 553.

---

[18] Hopkins, The Law of Tax-Exempt Organization (4th ed.) 247 (1983); he does not cite a source.

CONGRESSIONAL INVESTIGATIONS

Between the years of 1950 and 1969 congressional interest in tax-exempt organizations seemed to focus on private foundations. During that period there were three major investigations of private foundations. None of these was conducted by a tax-writing committee. The first two were born of searches for Communists and Communist-influenced organizations in the early 1950s.[19] They did not focus on the lobbying or political activities of these organizations. The third was a 10-year investigation conducted by Representative Wright Patman and the Select Committee on Small Business, Subcommittee on Foundations. Mr. Patman was initially chairman of the Select Committee on Small Business; later he chaired the Committee on Banking and Currency. It is not surprising, therefore, that the focus of Mr. Patman's investigations was, as stated in the title of the eight installments of his report, Tax-Exempt Foundations and

---

[19] The first of these was the Cox Committee, formally known as the House Select Committee to Investigate Tax-Exempt Foundations and Comparable Organizations created April 4, 1952. The Committee held hearings [Tax-Exempt Foundations: Hearings before the House Select Committee to Investigate Tax-Exempt Foundations and Comparable Organizations, 82d Cong., 2d Sess. (1952).] and filed H.R. Rep. No. 2514, 82d Cong., 2d Sess. (1953). In 1953 the House created the Reece Committee, the Special Committee to Investigate Tax-Exempt Foundations and Comparable Organizations. The hearing record [Tax Exempt Foundations: Hearings before the House Special Committee to Investigate Tax-Exempt Foundations and Comparable Organizations , 83d Cong., 2d Sess., on H. Res. 217 (1954)] and H.R. Rep. No. 2681, 83d Cong., 2d Sess. (1954) were published in 1954.

Charitable Trusts: Their Impact on Our Economy.[20]

Although lobbying and political activities were by no means the focus of the Patman investigations, the reports do single out some instances that Mr. Patman felt illustrated the laxness with which the Internal Revenue Service was enforcing the tax laws. The first report contained 17 recommendations.[21] The last recommendation included giving consideration to establishing a regulatory agency for the supervision of tax-exempt foundations because

> In the area of foundations, the Treasury Department has been so lax in enforcement of the law and regulations that it amounts to irresponsibility and a virtual abdication from the task of administration.[22]

Two of the ways that the Internal Revenue Service's administration of the tax laws could have been improved, according to the report, were that the tax returns of foundations should require disclosure of (1) amounts spent for instigating or promoting legislation, or political activities, or amounts paid to other organizations for the purpose; and (2) amounts spent for TV, radio, and newspaper advertising. The report also recommended "stiff penalties and revocation of tax exemption for improper or insufficient reporting" to help curb abuses.[23]

The Patman reports give illustrations and anecdotal evidence of the practices that Mr. Patman found objectionable:

---

[20] The first report was styled Chairman's Report to the Select Committee on Small Business, 87th Cong., 2d Sess., Tax-Exempt Foundations and Charitable Trusts: Their Impact on Our Economy (Comm. Print 1962) (hereinafter, Patman Report, 1st Installment). The subsequent reports had the same title followed by an installment number, but the report was described as the Subcommittee Chairman's Report to Subcommittee No. 1, Select Committee on Small Business.

[21] Patman report, 1st Installment, at 133-135.

[22] Id., at 134.

[23] Id., at 135.

The Tax Foundation, Inc., an "educational" organization furnished its finding free to the Washington press, and a recent issue of its Review led off with a criticism of the Federal income tax. This was criticized in a news article which was reprinted in the report as enabling people to make tax-deductible contributions to spread views with a "political flavor."[24]

The William Volker Fund spent $8,056 for the distribution of what it described as "nonpartisan presidential election posters" in 1956.[25]

Hughes Aircraft Company, a subsidiary of the Howard Hughes Medical Institute, and the Ford Foundation spent $931,441 for public relations purposes.[26]

The Ford Foundation donated $2,400,000 to the Brookings Institution for a program of research and education on taxation and public expenditures.[27]

The Government Affairs Foundation, Inc., funded by Gov. Nelson A. Rockefeller, paid no money out in contributions, gifts, or grants, but it did pay out $160,000 in salary and expenses to Frank C. Moore, a former Lieutenant Governor of New York.[28]

The Lincoln Foundation paid $13,200 during 1966, to a columnist, Raymond Moley, who was a fervent advocate of perpetual foundations in his columns as a fee for being an Advisor and Director to the Foundation.[29]

Stories in the Washington Post pointed out that the Ford Foundation had paid $131,069.50 in travel and study grants to eight members of Robert Kennedy's Senate staff after his death in 1968.[30]

In 1965 the Treasury issued a report on private foundation in response to requests from the House Commitee on Ways and Means and the Senate Finance

---

[24] Id., at 13.

[25] Id., 13.

[26] Id., at 51.

[27] Id., at 73.

[28] Patman report, 4th Installment, 89th Cong., 2d Sess., at 5 (1966).

[29] Patman report, 6th Installment, 90th Cong., 2d Sess. at 23 (1968).

[30] Patman report, 7th Installment, 91st Cong., 1st Sess. at 4-5, 9-32 (1969).

Committee, but there was no discussion of lobbying or electioneering in the report.[31]

THE TAX REFORM ACT OF 1969 (P.L. 91-172)

There was no specific bill before the Committee on Ways and Means when it began its hearings on tax reform in February 1969. A series of studies and proposals for tax reform developed by the Johnson Treasury Department served as the basis for discussion in the hearings. [32]

HOUSE HEARINGS

The Committee on Ways and Means held four days of hearings on private foundations. The principal focus of these hearings was not the problems with lobbying and electioneering by private foundations--the main concerns were the concentration of wealth in foundations and the ability of the wealthy to use foundations for their own purposes and avoid paying taxes on the income of the foundations. However, these issues did not entirely escape notice. When McGeorge Bundy of the Ford Foundation appeared as a witness, he was interrogated at length on details of certain Ford Foundation grants which had financed voter registration drives in Cleveland before the election of Mayor Carl B. Stokes and grants to ease the transition from public to private life for eight aides of Senator Robert F. Kenndy after his death in 1968.

HOUSE REPORT

The Committee on Ways and Means hearings concluded on April 25, 1969. H.R. 13270 (91st Cong.) was introduced on August 1, 1969. One of the major groups of tax reforms proposed was distinguishing among public charities, private foundations, and private operating foundations. Private foundations were to be closely regulated through a series of excise taxes for certain infractions which did not rise to the level where loss of exemption would be merited.

---

[31] House Committee on Ways and Means, 89th Cong., 1st Sess., Treasury Department Report on Private Foundations. (Comm. Print 1965). [Same print also issued by Senate Committee on Finance].

[32] U.S. Treasury Department, Tax Reform Studies and Proposals, a joint publication of the House Committee on Ways and Means and the Senate Committee on Finance, 91st Cong., 1st Sess. (Comm. Print Feb. 5, 1969).

Under then-existing law, exempt organizations were prohibited from participating in any political campaign and could not have a substantial part of their activities consisting of propaganda or attempting to influence legislation. The Committee on Ways and Means Report[33] indicated that the standards as to the permissible level of activities under existing law were sufficiently vague to encourage subjective application of the law. The Committee was concerned that the substantiality test might permit large organizations to do more lobbying than small organizations. The fact that organizations which lost their exemptions because of excessive lobbying could become exempt under another provision of the Code and continue to use their endowments for lobbying was also a problem.[34]

The Committee saw another problem arising from the absolute prohibition upon involvement in political campaigns on behalf of any candidate for public office. The absolute prohibition often resulted in unreasonably severe or unreasonably light punishment for the particular infraction. The Committee indicated that they had become aware of the following problems: taking sides in a referendum; financing voter registration drives in limited geographical areas; using money to publicize views, personalities, and activities of certain candidates; and using money to provide "educational" grants to enable people to take vacations, have paid interludes between jobs, and to subsidize the preparation of materials furthering specific political viewpoints.[35]

---

[33] H.R. Rep. No. 413, Pt. 1, 91st Cong., 1st Sess. 31-35 (1969)

[34] Id., at 32.

In order to place more effective limitation on the extent to which tax-deductible and tax-exempt funds could be dispensed by private persons, the Committee developed a tax penalty for expenditures that it believed should not be carried on by exempt organizations. The report described the bill as prohibiting private foundations from spending money for lobbying, electioneering (including voter registration drives), and grants to individuals (unless there are assurances that the grants are made on an objective basis). Any improper expenditure would be subject to tax.

Expenses incurred in connection with grassroot campaigns or other attempts to urge or encourage the public to contact members of a legislative body for the purpose of proposing, supporting, or opposing legislation would be subject to tax, as would direct attempts to persuade members of legislative bodies or governmental employees to take specific positions on specific legislative issues. The report explained that this prohibition did not extend to discussions of broad policy problems and issues. Foundations were still to be permitted to make available results of nonpartisan research or analysis and to appear before or communicate with any legislative body regarding decisions which might affect the existence of the organization. Grassroots campaigns were still prohibited though.[36]

Voter registration drives could be conducted by private foundations providing that they were nonpartisan and met certain other standards. The League of Women Voters Education Fund and the Southern Regional Council were held up as the kind of organizations that would be permitted to conduct voter registration drives.[37]

---

[35] Id., at 32.

[36] Id., at 33.

Private foundations were also prohibited from making nonobjective grants to individuals. Grants other than scholarships were to be made with a tangible product or specific achievement in mind.

The penalty for violating any of these provisions was to be a tax of 100 percent of the amount paid or incurred by the private foundation for the improper purpose. This was to prevent large foundations from hiding behind the substantiality test, it was also designed to make the penalty proportional to the infraction. The foundation manager who agreed to make the expenditure knowing that it was improper was to be subject to a tax equal to 50 percent of the amount of the expenditure. There was no cap on this penalty. There were second and third levels of sanctions for repeated or flagrant violations or failure to correct the situation.

SENATE HEARINGS

When the Senate Finance Committee hearings were held on the House bill, most of the testimony on foundations was a reaction to the House bill provisions.[38] The Foundations Coordinated Testimony Group formed by a group of representatives of private foundations testified on many topics. They were concerned that prohibiting any attempt to influence legislation might prevent them from studying controversial problems which might be the subject of legislation, from recommending legislation as a solution to social problems, and from attempting to educate the public on such topics. They were also concerned that the partial prohibition against grants to individuals might handicap programs providing fellowships and awards.[39]

---

[37] Id., at 34.

[38] Tax Reform Act of 1969: Hearings on H.R. 13270 before the Senate Finance Comm., 91st Cong., 1st Sess., pt. 1,2,6 (1969).

SENATE REPORT

In the lobbying and electioneering provisions, the bill, as reported by the Senate Committee on Finance, was substantially similar to the bill passed by the House. The Senate did make a few amendments though. The Finance Committee recommended permitting discussion and comment upon policy problems, social or economic issues, and other broad issues, where such activities would be considered educational under existing law. The Committee also indicated that lawmakers should be able to request advice and technical assistance from private foundations. The Committee also decided that if a noncommercial educational broadcasting station was a private foundation, it would not violate the lobbying provisions if it adhered to the Federal Communications Commission's regulations and the "fairness doctrine."[40]

In the electioneering provisions, the Finance Committee modified the House provisions to provide that electioneering occurred only when the purpose was to influence the outcome of a specific election. It was concerned that otherwise almost any statement or study or general educational activity could at a future date become an issue in an election, depending on the views of the candidate at that time.[41]

The Finance Committee deleted a provision in the House bill which would have permitted private foundation funds to be used for voter registration drives. It believed that the usual motivation for voter registration drives was to influence the outcome of an election.[42]

---

[39] Id., at 5344-5519.

[40] S. Rep. No. 552, 91st Cong., 1st Sess. 48-49 (1969).

[41] Id., at 49.

The Finance Committee penalties were lighter than those proposed in the House. The initial sanction was to be equal to 10 percent of the amount improperly spent (plus a tax of 2 1/2 percent on the foundation manager who knowingly permitted the improper expenditure). The heavier sanction (100 percent penalty) would be applied later only if the foundation refused to correct the earlier improper action to the extent possible. The Senate capped the heavier sanction for the foundation manager at $10,000. Second and third level penalties were also imposed.[43]

SENATE ACTION

On the Senate floor there were several amendments. Certain private foundations were permitted to conduct voter registration drives.

CONFERENCE REPORT [44]

P.L. 91-172 inserted a new section 4945 into the Internal Revenue Code. This provision imposed an excise tax on certain expenditures by private foundations. Not surprisingly, the list that became law was a blend of the House and Senate provisions.

The initial tax (10 percent on the foundation and 2 1/2 percent on the foundation manager) came from the Senate bill. Failure to correct the expenditure within the correction period results in a 100 percent tax on the foundation and a 50 percent tax on the foundation manager. These provisions were from the House bill, but there were caps at both levels on the foundation manager's liability, an idea which came from the Senate.

---

[42] Id., at 49.

[43] Id., at 51.

[44] H.R. Rep. No. 782, 91st Cong., 1st Sess. 284-286 (1969).

A taxable expenditure was defined as any amount paid or incurred by a private foundation

> (1) to carry on propaganda, or otherwise attempt to influence legislation, within the meaning of subsection (e),
>
> (2) except as provided in subsection (f), to influence the outcome of any specific public election, or to carry on, directly or indirectly, any voter registration drive,
>
> (3) as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirement of subsection (g),
>
> . . . .[45]

The conference committee adopted the broader language of the House in (d)(1), but included language in the conference report indicating that "it is not intended to prevent the examination of broad social, economic, and similar problems of the type the Government could be expected to deal with ultimately, even though this would not permit lobbying on matters which have been proposed for legislative action."[46] The conference report also indicated accord with the Senate report language on noncommercial educational broadcasting.

Nonpartisan research and analysis is permitted, as is testimony relating the the tax-exempt status of the organization itself and testimony offered at the request of the legislature to that legislature.

Expenditures for voter registration can be made by certain tax-exempt private foundations if their activities are nonpartisan, are not confined to one specific election period, and are carried on in five or more States.

---

[45] IRC section 4945(d).

[46] H.R. Rep. No. 782, 91st Cong., 1st Sess. 284 (1969).

The organization cannot accept contributions which are conditioned on use in a particular area or during a particular election. The organization must also meet certain expenditure and support requirements.

Grants to individuals are required to be made on an objective and nondiscriminatory basis and meet the requirements for being a scholarship, a prize or award made to members of the general public, or have as its purpose achievement of a specific objective, production of a report or similar product, or improvement or enhancement of literary artistic, musicial, scientific, teaching, or other similar capacity, skill, or talent of the grantee.

HEARINGS AND STUDIES: 1972-1975

1972 HEARINGS

On May 3, 4, and 5, 1972, the Committee on Ways and Means held hearings on a bill, H.R. 13720 (92d Cong.) which presaged IRC section 501(h) adopted in 1976.[47] Under that bill an electing public charity (including churches) could spend up to 20 percent of its annual disbursements for charitable purposes on attempts to influence legislation. Communications with members or employees of legislative bodies and direct communications with members would be permitted on matters directly affecting the charitable purpose of the organization. Only 5 percent of its annual charitable disbursements could be used for grassroots lobbying (i.e. attempts to influence the general public and attempts to influence legislation not directly related to a charitable purpose of the organization). Activities clearly permitted to private foundations under present law would also be clearly permitted to public charities (e.g. nonpartisan analysis, testimony at the request of Congress, lobbying for organization's life or exempt status).

In testimony by Edwin S. Cohen, the Department of Treasury recommended that businesses and charitable organizations be put on a par with each other, that charities be permitted to do what business organizations are allowed to do (i.e. take a business expense deduction).[48] Conversely, if businesses cannot lobby the grass roots then neither should charities. Mr. Cohen suggested that the present scope of grassroots lobbying and legislative lobbying not be expanded except in areas where there was an obvious business-charitable interest conflict. He cited ecological and environmental concerns as examples of areas where there was a direct conflict. He stated Congress would be vastly expanding the areas in which lobbying activities would occur if lobbying were permitted on matters which do not involve such confrontations. He cited divorce laws, abortion laws, and political questions as examples.

---

[47] Legislative Activity by Certain Types of Exempt Organizations: Hearings before the House Comm. on Ways and Means on H.R. 13270, 92d Cong., 2d Sess. (1972).

[48] Id., at 11.

Representative Ullman questioned whether the "direct concern" criteria was a workable one in view of the broad concerns of some organizations.

The Administration through Russell E. Train, Chairman of the Council on Environmental Quality also supported the bill, but much more enthusiastically than had Mr. Cohen. Most of the representatives of charitable organizations supported the bill, too, but some thought that it did not go far enough. Church organizations had reservations about whether they should be included in the bill and the constitutionality of any restrictions on their First Amendment rights.

The bill does not appear to have been reported by the Committee or considered by the House.

FILER COMMISSION REPORT

In 1975 the Commission on Private Philanthropy and Public Needs, chaired by John H. Filer, issued its report, Giving in America: Toward a Stronger Voluntary Sector. This was a privately funded commission, formed in 1973 under the inititative a John D. Rockefeller 3rd and the encouragement of Wilbur D. Mills and members of the Department of Treasury. Its goals were to study and make recommendations about philanthropy and philanthropic institutions in the United States. One of its many recommendations was to allow exempt organizations, other than private foundations, the same freedom to influence legislation as businesses and trade association.

DONEE GROUP REPORT

In response to the Filer Commission report, the Donee Group, a coalition of public interest, social action, and volunteer groups acting as advisors to the Commission on Private Philanthropy and Public Needs, put out its own undated report and recommendations.[49] The Donee Group thought that charitable organizations should take a greater role in the public decision-making process. To that end, they recommended that all limits on lobbying be removed except for a restriction prohibiting the formation of an organization strictly for the purpose of influencing legislation.

---

[49] Donee Group, Private Philanthropy: Vital & Innovative: or Passive & Irrelevant? Report and Recommendations (Washington, DC undated).

1975 - PUBLIC LAW 93-625 AND THE POLITICAL ORGANIZATION EXEMPTION

On April 4, 1974, the House Committee on Ways and Means reported H.R. 421, a bill relating to suspension of the tariff on certain upholstery equipment (see H. Rep. No. 93-972, 93rd Cong., 2d Sess. (1974)). The House of Representatives passed the bill on April 8, 1974. In the Senate, the bill was referred to the Committee on Finance on April 10, 1974. On December 16, 1974, the Senate Committee on Finance reported H.R. 421, with amendments, including several dealing with certain tax aspects of campaign financing and related matters (see S. Rep. No. 93-1357, 93d Cong., 2d Sess. (1974)). The bill, with the Committee amendments and a pertinent floor amendment, was passed by the Senate on December 17, 1974. On the same day, the Senate requested a conference. And, on December 18, 1974 the House of Representatives agreed to a conference. A conference report was filed in the House of Representatives on December 19, 1974 (see H. Rep. No. 93-1642, 93d Cong., 2d Sess. (1974)). On the day the 93d Congress adjourned, December 20, 1974, both the House of Representatives and the Senate agreed to the conference report, including all the pertinent tax provisions. On January 3, 1975, President Ford signed H.R. 421 into law (Public Law 93-625).

This law included several provisions of significance to political activity and exempt status under present law.[50] First and of particular import, it added sec. 527 to the Internal Revenue Code. That section provides among other things for tax-exempt status for political parties, committees, associations, funds, or other organization (incorporated or not) organized and operated primarily for the purpose of (directly or indirectly) accepting contributions or making expenditures to influence the selection, election, or appointment of an individual to public or political office.[51] Second, the law amended sec. 2501 to expressly exclude political contributions from the gift tax.[52]

---

[50] We have not discussed provisions relating to the limited deduction or credit for political contributions, to newsletter funds or income tax treatment gifts of appreciated property to political organizations.

The background and rationale for these changes in the law were explored in the report of the Senate Finance Committee,[53] where the relevant changes originated. That report indicated that historically the tax status of political organizations had been uncertain, but that during the period from 1968 to 1973 the IRS had moved toward the position that such organizations were taxable. Earlier the IRS had generally not required such organizations to file returns, apparently viewing their receipts as consisting primarily of gifts rather than taxable income. A 1973 IRS decision treating political organizations as taxable entities apparently prompted the Senate action to create a special tax code exemption for such entities and exempting most of their income from tax. Such entities the Senate report said, were not engaged in a trade or business but in political activity, and while the former was appropriately subject to a tax on income, the latter was not.

The Senate Finance Committee report includes the following summary of the background and rationale for this change.[54]

> Until recently, the tax status of political organizations has been somewhat uncertain. Historically, the Internal Revenue Service has not generally required the filing of income tax returns by political organizations. Presumably, this practice resulted from the belief that

---

[51] Pub. L. No. 93-625, sec 10, 88 Stat. 2116 (Codified at I.R.C. sec. 527).

[52] Pub. L. No. 93-625, sec. 14, 88 Stat. 2121 (codified at I.R.C. sec. 2501(a)).

[53] S. Rep. No. 1357, 93d Cong., 2d Sess.

[54] Id., at 25-26.

virtually all of the receipts of political organizations were from gifts and that these organizations would not have taxable income. However, in 1968 the Internal Revenue Service announced that investment income of a political campaign fund constitutes gross income and may be reported on a fiduciary tax return, (Form 1041) with the tax due thereon paid with the filing of the return. Recently, as a result of the increasing practice of individuals making political contributions in the form of appreciated property, the Internal Revenue Service conducted a study of the tax consequences relating to these transactions. This study also included the tax status of political organizations in general.

On August 1, 1973, after conducting public hearings on these questions, the Internal Revenue Service announced that political parties and committees are taxable organizations and must pay tax on interest, dividends from investments, income from ancillary commercial activities, and gains from sales of appreciated property. In its subsequent ruling, the Service stated that campaign contributions are not includable in gross income and that expenditures for political purposes and expenses incurred for fund-raising activities are not deductible. On the other hand, expenses directly attributable to activities undertaken for the production of income which is taxable (interest dividends etc.) are deductible. Expenses attributable to the sale of appreciated property are to reduce gross proceeds in determining gain or loss realized on the sale. Under the ruling, political organizations may be treated as corporations, trusts, or possibly partnerships depending upon the facts and circumstances of the individual organization.

The Service also has ruled that political organizations with taxable incomes of $100 or less are not required to pay taxes or file returns for taxable years beginning before January 1, 1975.

> Because the questions involved in this area require a delicate balance between the need to protect the revenue and of the need to encourage political activities which are the heart of the democratic process, the committee has examined the entire problem of the tax treatment of these organizations.
>
> In general, the committee's bill provides that political organizations are to be treated as tax-exempt organizations, since political activity (including the financing of political activity) as such is not a trade or business which is appropriately subject to tax. However, where assets are not currently used by a political organization for political activities, but are invested for use at a later date, the income from the investment (less direct expenses incurred in earning that income) is to be subject to tax.

In its discussion of the new provision for tax-exempt 527 political organizations, the Finance Committee devotes some of its attention to the relationship between these organizations and others exempt under 501.[55]

> Exempt organizations which are not political organizations. Under present law, certain tax-exempt organizations (such as Sec. 501(c)(4) organizations) may engage in political campaign activities. The bill generally treats these organizations on an equal basis for tax purposes with political organizations. Under the bill, organizations which are exempt under Section 501(a) and are described in Section 501(c), that engage in political activity, are to be taxed on their net investment income in part as if they were political organizations. Thus, an exempt organization is to be subject to this tax if it spends any amount on the nomination, election, etc., of a candidate for public office, etc. However, these organizations are to be taxed only to the extent they actually operate as

---

[55] Id., at 29-30.

political organizations (that is, to the extent of their politically expenditures). Therefore, if the amount expended for political purposes is less than the net investment income, the lesser amount is to be the tax base. The bill does not require "tracing" in this regard. Thus, the tax is to apply even though the organization uses its investment income exclusively for nonpolitical purposes and makes its political expenditures entirely out of funds other than its investment income.

To avoid double taxation (and double deductions), the bill provides that income and deductions taken into account for purposes of the tax on unrelated business income of such exempt organizations are not to be included as either income or deductions in determining net investment income under the political organization provisions.

It is not intended that the Section 501(c) exempt organization be absolutely liable for any expenditures made by an organization to which it gives funds. However, if the payment is made for any of the political purposes described in this section, then the exempt organization is to be treated as having indirectly made the political expenditure. Also, if there are reasonable questions as to whether funds will be spent for political purposes and the exempt organization wishes to avoid imposition of the tax, it would be expected to take reasonable steps to see that the recipient organization does not spend funds for political purposes. In administering this provision, the Internal Revenue Service could, for example, provide that establishment of trust funds or other appropriate methods of segregating the payments will be satisfactory in demonstrating that indirect political expenditures do not result from the payment by the exempt organization.

The committee expects that generally, a Section 501(c) organization that is permitted to engage in political activities would establish a separate organization that would operate primarily as a political organization, and directly receive and disburse all funds related to nomination, etc., activities. In this way, the campaign-type activities would be taken entirely out of the Section 501(c) organization, to the benefit both of the organization and the administration of the tax laws.

Under present law (Section 610 of title 18 of the United States Code), a corporation or a labor organization which is otherwise forbidden to make contributions or expenditures in connection with Federal elections to public office or to political party office, may nevertheless establish a "separate segregated fund" which is maintained by the corporation or labor organization. The separate segregated funds is permitted under the statute to be utilized for political purposes.

For purposes of the rule in this bill regarding the treatment of exempt organizations (and for purposes of the definition in this bill of "political organization"), a separate segregated fund maintained by an exempt organization (a labor union described in Sec. 501(c)(5), a chamber of commerce, etc., described in Sec. 501(c)(6)), is to be treated as an entity which is separate from the exempt organization maintaining the fund. In such a situation, where the contributions are collected by employees of the exempt organization and are placed directly into the accounts of the separate segregated fund, these contributions are not to be treated as having come from the exempt organization. The amount subject to tax on account of those contributed amounts is to be measured by the political organization taxable income and the capital gains of the separate segregated fund in the same manner as other political organizations, and not by the income of the exempt chamber of commerce or labor union.

The committee understands that, in a number of States, exempt chambers of commerce and labor unions may establish funds similar to the Section 610 separate

> segregated funds. Although the requirements as to the manner of collection of contributions in those States, for State elections, may be somewhat different from the requirements under Federal law with regard to Federal elections, where the State statutes are similar to the Federal in this respect, then the separate segregated funds or their equivalents are to be treated the same as the Section 610 separate segregated funds for purposes of this bill. In such a case, if the exempt organization technically receives the contributions or dues but the exempt organization does not receive any interest, etc., income on those contributions or dues and promptly transfers the contributions or dues to the separate segregated fund, then the chamber of commerce or labor union is to be treated as not having made a political expenditure of those contributions or dues.
>
> This provision is not intended to affect in any way the prohibition against certain exempt organizations (e.g., Sec. 501(c)(3)) engaging in "electioneering" or the application of the provisions of Section 49-45 to private foundations.

The report apparently recognizes that exempt organizations which are not political organizations will and can create separate political organizations. Indeed, this seems to have been intended. It seems equally clear, however, that it did not intend to affect the prohibition against electioneering by 501(c)(3) organizations. It is doubtful that the Committee foresaw degree of activity or the extent of the interaction which appears to characterize the relationship between secs. 501(c)(3)s, other 501(c)s, and PAC's today.

The exclusion of political contributions from the tax on gifts was developed in a situation where the historical position of the I.R.S., that the gift tax applied, had been rejected by the Fifth Circuit's Court of Appeals.[56] The IRS, in response, had announced that it would follow that decision only in the Fifth Circuit in cases "on all fours with the "case in question.[57] The Senate Finance Committee adopted the Fifth Circuit's position as the one which should apply uniformly by statute. It reasoned "that it is inappropriate to apply the gift tax to political contributions because the tax system should not be used to reduce or restrict political contributions."[58]

---

[56] Stern v. United States, 436 F2.d 1327 (5th Cir. 1971).

---

[57] Rev. Rul. 72-583, 1972-2 C.B. 534.

[58] S. Rep. No. 1357, 93d Cong., 2d Sess. 32.

TAX REFORM ACT OF 1976 P.L. 94-455

The Tax Reform Act of 1976 added sections 501(h) and 4911 to the Internal Revenue Code. This section permits certain 501(c)(3) organizations to elect to replace the "substantial part of activities" test with a limit defined in terms of expenditures for influencing legislation.

This provision was adopted by the House as part of H.R. 13500 (not part of the Tax Reform bill). The Senate incorporated provisions similar to those in H.R. 13500 and added them to the Tax Reform bill. The Senate version of the bill was adopted in conference, but the conference report makes it clear that the conferees intended to specifically incorporate the House report by reference except for one paragraph.

HOUSE HEARINGS

The Committee on Ways and Means held hearings on H.R. 13500 on May 12, 1976.[59] William M. Goldstein, Deputy Assistant Secretary of Treasury for Tax Policy stated that the bill was the product of a number of attempts to reach a compromise among representatives of conflicting interests. It was designed to provide certainty and predictability to the administration of the lobbying provisions of section 501(c)(3). He said it provided clear quantitative measures of permissible lobbying activities, defined with some precision which activities constitute lobbying and which do not, and enlarged the scope of activities in which charitable organizations may engage without adverse tax consequences.[60] The bill seemed to enjoy wide endorsement by public charities.

HOUSE REPORT

The Ways and Means report indicated that the Committee had amended the bill before reporting it. It summarized the bill as providing a new elective set of requirements for determining whether a charitable organization (other than churches, church organizations, and private foundations) has engaged in excessive lobbying activities sufficient to cause it to lose its exemption and qualification for receiving deductible contributions.[61]

---

[59] Influencing Legislation by Public Charities: Hearing on H.R. 13500 before the House Comm. on Ways and Means, 94th Cong., 2d Sess. (1976).

[60] Id., at 11.

The report explained the reason for the bill was that, except for private foundations, the only sanctions for excessive lobbying were loss of exemption or loss of qualification to receive deductible contributions. Some organizations (especially those with substantial endowments) could split up their activities between a lobbying organization and a charitable organization. For those groups, the restrictions had little effect and may have discouraged enforcement. For organizations which could not do that, loss of exemption would be a severe blow. The bill tried to remedy this problem by providing explicit limits keyed to the size of the organization, and a penalty equal to 25 percent of the excessive lobbying expenditures. Revocation was reserved for those cases where excessive lobbying occurs over a period of time.

H.R. 13500 was passed by the House 355-14 on June 8, 1976.[62]

SENATE HEARINGS

The Senate did not take oral testimony on the issue of charities influencing legislation, but the Chairman of the Coalition of Concerned Charities, Elvis J. Stahr, submitted written testimony which was printed in the record.[63] In his statement Mr. Stahr gives a history of the bill that he was endorsing (and that would eventually become an amendment to the Finance

---

[61] H.R. Rep. No. 1210, 94th Cong., 2d Sess. 7 (1976).

[62] 122 Cong. Rec. 16891 (June 8, 1976).

[63] Tax Reform Act of 1975: Hearings on H.R. 10612 before the Senate Comm. on Finance, 94th Cong., 2d Sess. 3263-3271 (1976). This statement was submitted before the House held its hearings on H.R. 13500.

Committee bill) and questions why it had taken seven years to get any legislative action in the area.

SENATE REPORT

The Committee on Finance Report [64] was issued July 20, 1976. It offers the same reasons for the change that the House offered in its report on H.R. 13500. The explanation of the provision is reproduced below.

> *Explanation of provision*
>
> The committee amendment permits public charitable tax-exempt organizations to elect to replace the present "substantial part of activities" test with a limit defined in terms of expenditures for influencing legislation. The basic permitted level of such expenditures ("lobbying nontaxable amount") for a year is 20 percent of the first $500,000 of the organization's exempt purpose expenditures for the year, plus 15 percent of the second $500,000, plus 10 percent of the third $500,000, plus 5 percent of any additional expenditures. However, in no event is this permitted level to exceed a "cap" of $1,000,000 for any one year.
>
> Within those limits, a separate limitation is placed on so-called "grass roots lobbying"—that is, attempts to influence the general public on legislative matters. This grass roots nontaxable amount is one-fourth of the lobbying nontaxable amount.
>
> The committee amendment is substantively the same as H.R. 13500, which was recently passed by the House, except that the House bill disallowed charitable deductions for out-of-pocket expenditures to influence legislation even if the expenditures were for the use of organizations which are ineligible to elect the expenditures test.
>
> *Sanctions.*—An electing organization that exceeds either the general limitation or the grass roots limitation in a taxable year is to be subject to an excise tax of 25 percent of its excess lobbying expenditures.[2] Furthermore, if an electing organization's lobbying expenditures normally (that is, on the average over a four-year period) exceed 150 percent of the limitations described above, the organization is to lose its exempt status under section 501(c)(3).[3]
>
> *Influencing legislation.*—For purposes of these new rules, the amendment defines the term "influencing legislation" as any attempt to influence any legislation through an attempt to affect the opinion of the general public or any segment thereof ("grass roots lobbying") and any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any other government official or employee who may participate in the formulation of the legislation ("direct lobbying").
>
> The committee amendment excludes from "influencing legislation" the following three categories of activities: (1) making available the result of nonpartisan analysis, study, or research; (2) providing technical advice or assistance in response to a written request by a governmental body; and (3) appearances before, or communications to, any legislative body with respect to a possible decision of that body which might affect the existence of the organization, its powers and duties, its tax exempt status, or the deduction of contributions to the organization.

---

[64] S. Rep. No. 938, Pt. 2, 94th Cong., 2d Sess. 79-85 (1976).

In addition, the committee amendment excludes communications between the organization and its bona fide members unless the communications directly encourage the members to influence legislation or directly encourage the members to urge nonmembers to influence legislation.[4]

Exempt purpose expenditures.—As indicated above, the determination of whether an electing organization is subject to the excise tax established by the amendment is to be made by comparing the amount of the lobbying expenditures with the organization's "exempt purpose expenditures" for the taxable year. The term "exempt purpose expenditures" includes the total of the amounts paid or incurred by the organization for exempt religious charitable, educational, etc., purposes.

In computing exempt purpose expenditures, amounts properly chargeable to capital account are to be capitalized. However, when the capital item is depreciable, then a reasonable allowance for depreciation, computed on a straight-line basis, is to be treated as an exempt purpose expenditure.

For purposes of these provisions, the term "exempt purpose expenditure" also includes administrative expenses paid or incurred with respect to any charitable, etc., purpose; it also includes all amounts paid or incurred for the purpose of influencing legislation, whether or not for exempt purposes.

Exempt purpose expenditures do not include amounts paid or incurred to or for a separate fund-raising unit of an organization (or an affiliated organization's fund-raising unit); they also do not include amounts paid or incurred to or for any other organization, if those amounts are paid or incurred primarily for fundraising.

Affiliation rules.—In order to forestall the creation of numerous organizations to avoid the effects of the decreasing percentages test used to compute the lobbying and grass roots nontaxable amounts, or efforts to avoid the $1,000,000 "cap" on lobbying expenditures, the amendment provides a method of aggregating the expenditures of related organizations.

If two or more organizations are members of an affiliated group, and at least one organization in that group has elected to come under the new rules of the committee amendment, then the calculations of lobbying expenditures and exempt purpose expenditures are to be met by taking into account the expenditures of the entire group. If the expenditures of the group as a whole exceed the permitted limits, each of the electing organizations is to pay the tax on its proportionate share of the group's excess lobbying expenditures. The nonelecting members of the group are to remain under existing law with regard to their expenditures and other activities.

Generally, two organizations are affiliated if (1) one organization is bound by decisions of the other organization on legislative issues, or (2) the governing board of one organization includes enough representatives of the other organization to cause or prevent action on legislative issues by the first organization.[5] Where organizations are affiliated, as described above, in a chain or similar fashion, all organizations in the chain are to be treated as one group of affiliated organizations. Thus, for instance, if organization Y is bound by the decisions of organization X on legislative issues and organization Z is bound by the decisions of organization Y on such issues, then X, Y, and Z are all members of one affiliated group of organizations. However, if a group of autonomous organizations control another organization but no one organization in the controlling group can, by itself, control the actions of the potentially controlled organization, the organizations are not treated as an affiliated group by reason of the "interlocking directorates" rule.

Where there is an affiliated group, a number of the provisions discussed above are to be applied as though the affiliated group constitutes one organization.

Disallowance of deduction for out-of-pocket expenses to influence legislation.—Under present law, a deduction is available for certain out-of-pocket expenditures incurred by a person on behalf of a charitable organization. Since, for purposes of the new expenditures test, it is necessary to have relevant expenditures appear in the books and records of the organizations, an expenditures test could readily be evaded if the lobbying could be conducted on behalf of the organization by individuals with deductible out-of-pocket contributions. Accordingly, the amendment provides that a person may not deduct out-of-pocket expenditures on behalf of a charitable organization if the expenditure is made for the purpose of influencing legislation[6] and if the organization is eligible to elect the expenditures test provided by the committee amendment.

Status of organization after loss of charitable status.—Under present law, an organization which loses its exempt status under section 501(c)(3) generally can nevertheless remain exempt on its own income (although generally ineligible to receive deductible charitable contributions) as a "social welfare" organization under section 501(c)(4)). The availability of this continued exemption permits an organization to build up an endowment out of deductible contributions as a charitable organization and then use that tax-favored fund to support substantial amounts of lobbying as a section 501(c)(4) social welfare organization.[7]

In order to prevent such a transfer of charitable endowment, the committee amendment provides that an organization which is eligible to elect under this provision cannot become a social welfare organization exempt under section 501(c)(4) if it has lost its status as a charity because of excessive lobbying. The committee amendment also gives the Treasury Department the authority to prescribe regulations to prevent avoidance of this rule (for example, by direct or indirect transfers of all or part of the assets of an organization to an organization controlled by the same person or persons who control the transferor organization).

Disclosure of lobbying expenditures.—In order to permit the public to obtain information as to lobbying expenditures by organizations that have elected to come under the standards of the new provisions, the amendment revises section 6033 to specifically require that any organization that has elected under these rules must disclose on its information return the amount of its lobbying expenditures (total and grass roots), together with the amount that it could have spent for these purposes without being subject to the new excise tax provided by the committee amendment. If an electing organization is a member of an affiliated group, then it must provide this information with respect to the entire group, as well as with respect to itself.

This amendment is not intended to restrict any authority that the Treasury Department may have under existing law to require exempt organizations to provide information for the purpose of carrying out the internal revenue laws.

Elections.—An election by an organization to have its legislative activities measured by the new expenditures test is to be effective for all taxable years of the organization which end after the date the election is made, and begin before the date the election is revoked by the organization. Thus, an organization can, at any time before the end of the taxable year, elect the new rules for that taxable year. Once such an election is made, it can be revoked only prospectively—that is, it cannot be revoked for a taxable year after that year has begun.

Eligible organizations.—As a result of concerns expressed by a number of churches and in response to their specific request, the committee amendment does not permit a church or a convention or association of churches (or an integrated auxilary or a member of an affiliated group which includes a church, etc.), to elect to come under these provisions.[8]

CONFERENCE REPORT

The Senate does not appear to have amended this provision on the floor. The conference report indicates that the Senate version of the bill was adopted.[65] The provision was contained in section 2503 of the bill and primarily added sections 501(h) and 4911 to the Internal Revenue Code.[66]

---

[65] S. Rep. No. 1236, 94th Cong., 2d Sess. 532-534 (1976).

[66] P.L. 94-455, Sec. 2503.

III. RECENT DEVELOPMENTS AND CONTINUING ISSUES

As our discussion of the historical development of the tax law limits on lobbying and political activity suggests, calls for such limits on legislative and political activity of tax-exempt charities or foundations have apparently been generated by perceptions of excessive involvement by particular organizations and a belief that charitable deductions should by given only for money used for charitable purposes. Legislative and political activity have not been viewed as charitable. Drawing the line has proved more difficult with constitutional considerations and competing, sometimes conflicting, policy concerns. The result has been a statutory scheme which recognizes and accords different types of treatment to different types of tax-exempt organizations. A section 501(c)(3), such as the National Multiple Sclerosis Society, is subject to limits on both legislative and political activity, while a sec. 501(c)(4), such as the National Rifle Association, is free and expected to lobby. Tax-exempt PAC's exist for political activity. These may be linked to secs. 501(c)(4)s and (c)(3)s in various ways. Indeed, as noted in our historical overview and emphasized in our discussion of maximizing legislative and political activity under current law (Part II), spin-offs of political organizations by other types of tax-exempt organizations were anticipated and have occurred.

As a number of newspaper and magazine stories during the past several years have called into question the scope of legislative and political activity by tax-exempts and the relationship between candidates, prospective candidates, issues foundations, single issue groups engaged in lobbying, and political action committees, the old issues have emerged and questions raised about the adequacy of present law and/or its enforcement. Changes in federal election law and adoption of the statutory tax-exemption for political organizations in the 1970's were followed by a proliferation of multiple candidate PAC's associated with potential candidates. A 1986 CRS report[67] identified a number of such organizations associated with or sponsored by prospective 1988 presidential candidates including: (1) the Republican Majority Fund, a PAC associated with former Senator Howard Baker; (2) Americans for the National Interest (PAC) and American Horizons Inc., (tax-exempt foundation), associated with former Arizona governor, Bruce Babbitt; (3) Fund for America's Future, Inc., a PAC associated with Vice President George Bush; (4) Campaign America, a PAC associated with Senator Robert Dole; (5) Effective Government Committee, a PAC associated with Representative Richard Gephardt; (6) Center for a New Democracy, a private foundation associated with former Senator Gary Hart; (7) Campaign for Prosperity (PAC) and Fund for the American Renaissance (private foundation), associated with Representative Jack Kemp; (8) The Freedom Council (private foundation), associated with Marion G. (Pat) Robertson.

The 1986 CRS report also lists a number of possible advantages to potential candidates from establishment of multiple candidate PAC's and private foundations for prospective candidates:[68]

> These multicandidate PAC's and private tax-exempt foundations offer certain advantages to potential federal office candidates who have announced their candidacies for federal office and have established authorized campaign committees. For example, potential and unannounced federal office candidates seem to be able to use the funds of such PAC's and private foundations for such expenses inter alia as: (1) travel, (2) establishing field organizations, (3) articles and newsletters authored hospitality suites, (5) formation of steering committees, (6) the development of direct-mail donor lists, (7) the

---

[67] CRS Report, Legal Analysis of Specialized Multicandidate PAC's and Tax-Exempt Private Foundations of Potential Federal Office Candidates, Thomas M. Durbin (Aug. 12, 1986) at 1-2.

[68] Id., at 2.

> payment of salaries of political staffs and off full-time specialized aides, (8) the payment of retainers for consultants, (9) the payment for mailings, (10) organizing volunteers, (11) recruiting delegates, (12) developing policy papers, (13) Washington office expenses, and (14) receptions.

An article appearing in the February 23, 1987, edition of The National Law Journal entitled "Tax Exempt Foundations: What Is Legal?"[69] discusses this inter-relationship, its utility for candidates and issue groups, and includes interviews with tax lawyers and advisers. Briefly, a prospective candidate can create a sec. 501(c)(3) educational organization funded with tax deductible contributions to research issues, prepare and issue reports (making liberal use of the candidate's name and biographical data), provide educational support (including travel expenses) to the prospective candidate, and permit him to speak and write supported by tax deductible contributions. The sec. (c)(3) can also develop mailing lists of interested parties and sell them to related sec. (c)(4)'s and PAC's. The social welfare organization can lobby for these ideas. Indeed, as The National Law Journal article notes political ideas, can be promoted by issue groups using the same "piggy backing" techniques of secs.(c)(3)'s, and (c)(4)'s and political action committees that prospective candidates have used.

One well publicized example of the latter involves the activities of Carl R. Channell, head of the National Endowment for the Preservation of Liberty (a private foundation), Sentinel (a public interest sec. 501(c)(4) lobbying group) and two Washington based PACS's (Grow Washington and the American Conservative Trust). An associated press wire story on August 8, 1986, indicated that the National Endowment had run television advertisements supporting military aid to the contras, conducted polls on support for the strategic defense initiative in

---

[69] At pp. 1, 8, 10 and 11.

19 congressional districts, and was planning to run ads supporting that policy initiative in those districts. Other reports indicated that Sentinel was engaged in a $200,000 television campaign to persuade House democrats to support contra aid.[70]

These types of activities have resulted in renewed questioning of the adequacy of present limits on lobbying and political activity by tax-exempt entities.

Thomas B. Ripy

Thomas B. Ripy

Marie B. Morris

Marie B. Morris
Legislative Attorneys
American Law Division
March 10, 1987

---

[70] "Conservative Fund-Raiser Uses Commercials to Seek Votes for More Contra-Aid," Washington Post, June 22, 1986 at A6.

PART II

TACTICS FOR MAXIMIZING TAX-EXEMPT ORGANIZATIONS' FREEDOM FROM RESTRICTIONS ON LOBBYING AND CAMPAIGN INTERVENTION

Robert B. Burdette
Legislative Attorney
American Law Division
March 10, 1987

This discussion examines steps which might be taken to avoid the adverse tax consequences specified under various rules in the Internal Revenue Code and federal tax regulations that restrict lobbying by tax-exempt organizations and participation by such organizations in the campaigns of candidates for public offices. Two alternative courses of action are described: one suitable for cautious groups and the other for groups aggressively seeking to test the outermost frontiers separating officially tolerable from proscribed activities.

One initial observation which seems worthy of some emphasis is that useful lessons can be drawn from other, closely parallel legal contexts. Corporations and labor unions have for many years been subject to a prohibition (now part of the Federal Election Campaign Act) which makes it a felony to give or to spend treasury funds or dues money in connection with federal election campaigns. A substantial body of case law and practical experience for coping with this ban has accumulated over the years. In a similar vein but to a lesser degree, a useful body of case law and practical experience has also been developed in relation to various statutory restrictions on the use of government-supplied funds to pay for abortions. Both of these sources can be (and, indeed, have been) tapped for guidance in coping with the restrictions under examination.

I. A COURSE OF ACTION FOR CAUTIOUS GROUPS

A clear implication of both the majority and the concurring opinions in Regan v. Taxation With Representation, 461 U.S. 540, 551 (1983), is that groups of individuals who wish to enjoy tax-exempt status and certain other special tax benefits in carrying out activities of congressionally recognized benefit to society but who also wish to engage in lobbying or in advocating the election or defeat of candidates for public office should establish affiliated but distinct organizations with which to implement their disparate objectives.

In order to qualify not only for tax-exempt status but also as a recipient of tax-deductible "charitable" contributions, a section 501(c)(3) organization is indispensable (unless the group happens to be composed of veterans of military service who can organize as a group exempt under section 501(c)(19) and still qualify to receive deductible contributions by virtue of section 170(c)(3); the lobbying and campaign-intervention activities of 501(c)(19) organizations are not explicitly restricted by statute). A cautious group should be sure, at the time of applying for recognition of section-501(c)(3) status, to elect not to be treated as a private foundation. Thus, the special excise taxes on "taxable expenditures" and the so-called "responsibility rules" applicable to foundations can be avoided without foregoing significant benefits.

Even though section-501(c)(3) organizations are permitted to engage in a significant amount of lobbying (in some cases, as much as 25% of the resources of an organization can be devoted to such activity; see section 4911 of the Code), it is nevertheless probably worthwhile to establish a 501(c)(4) "social welfare" organization to serve as a backup vehicle for any lobbying in excess of that permitted by the 501(c)(3) organization. In this connection, it might be pointed out that the Supreme Court's majority opinion in the Taxation With Representation case, written by then-Associate Justice Rehnquist, clearly reflected a mistaken belief that 501(c)(3) organizations were entirely forbidden from engaging in any lobbying at all. Crucial to the Court's distinction of Speiser v. Randall, 357 U.S. 513 (1958),[1] and its progeny was the following analysis:

> . . . TWR is . . . incorrect when it claims that this case fits the Speiser - Perry model. The Code does not deny TWR the right to receive deductible contributions to support its non-lobbying activity, nor does it deny TWR any independent benefit on account of its intention to lobby. Congress has merely refused to pay for the lobbying out of public moneys. This Court has never held that Congress must grant a benefit such as TWR claims here to a person who wishes to exercise a constitutional right. [Op. cit., at page 545.]

The assertion that "Congress has refused to pay for . . . lobbying out of public moneys" was incorrect. That is not the law. So long as "insubstantial" (which, under sections 501(h) and 4911, can mean up to 25% of an organization's budget), a section -501(c)(3) organization's lobbying does qualify to be subsidized via the charitable contribution deduction, as well as tax-exempt status.

Neither a 501(c)(3) organization nor a 501(c)(4) is a suitable vehicle for engaging in candidate advocacy. A section-527 "political organization" is probably best suited to such a purpose. Such an organization is tax-exempt but, as in the case of a section-501(c)(4) organization, donors are not allowed deductions for their contributions to it.

A cautious group would not transfer donations collected by its 501(c)(3) organization to its 501(c)(4) and 527 affiliates. See the majority opinion in Taxation With Representation, op. cit., at pages 544-545, where Justice Rehnquist asserted that "TWR would, of course, have to ensure that the sec. 501(c)(3) organization did not subsidize the sec. 501(c)(4) organization." Intuitively, it seems likely that soliciting non-deductible contributions to the 501(c)(4) and 527 affiliates would be comparatively more difficult than soliciting deductible contributions to the 501(c)(3) organization. However, no evidence of what an economist might describe as the deductibility elasticity of contributions has been discovered.

---

[1] Speiser v. Randall was a tax case which involved a state's allowance of a special tax exemption for military veterans. To qualify for this special exemption, a veteran was obliged to sign a loyalty oath. The Supreme Court struck down the eligibility condition on the ground that an individual otherwise entitled to a tax benefit could not be forced to forego exercising a constitutionally protected freedom (such as the right not to sign loyalty oaths) in order to qualify for the tax benefit.

The regulations and statutory rules distinguish among various types of expression in terms of how much of each is allowed. In practice, however, some of the distinctions can, in appropriate factual settings, be elusive. For example, a so-called "editorial" advertisement commenting on a matter of public interest (e.g., the supposed advantages of the metric system of measurement) could conceivably become "grass roots lobbying" if a bill to require adoption of the metric system was pending before some legislative body in the locale where the advertisement appeared. In similar fashion, an otherwise unrestricted advertisement could conceivably amount to campaign intervention if it was presented during the campaign of a candidate who had chosen to make the subject of the advertisement an issue in the campaign. In fact, even before any official announcement of candidacy, an individual recognized by the media as a likely (or, perhaps, even only a potential) candidate could likewise take up the issue and thereby render a pertinent advertisement subject to restriction. A genuinely cautious group should consider such possibilities carefully in budgeting its expenditures and, at least in the case of its lobbying budget for its 501(c)(3) affiliate, it may wish to allow some margin of safety to accommodate what might be described as "unintentional" lobbying.

II. A COURSE OF ACTION FOR AGRESSIVE GROUPS

Like a cautious group, a group of individuals committed to an aggressive effort of probing the outermost limits of legally tolerable lobbying and candidate advocacy should establish affiliated yet distinct organizations. A single organization seeking all pertinent tax benefits but also wishing to engage in substantial lobbying and more than *de minimus* candidate advocacy was the very type of entity rejected in the *Taxation With Representation* case. Thus, the prospects for an outright challenge to the body of relevant regulations and statutory rules based on First and Fifth Amendment guarantees seem dim. That is not to say, however, that an aggressive group could not use constitutional arguments to justify activities which a cautious group would avoid.

The majority opinion in *Taxation With Representation* applied the line of reasoning enunciated in *Cammarano v. United States*, 358 U.S. 498 (1959), a tax case in which the Court had held that there is no constitutional right to a business-expense deduction for lobbying expenses incurred by a for-profit enterprise. The essential rationale was that the mere existence of a constitutionally protected freedom does not generate an entitlement to governmental subsidies with which to exercise that freedom. In addition to the majority opinion in *Taxation With Representation*, there was also a concurring opinion by Justice Blackmun, in which Justices Brennan and Marshall joined. The concurring members of the Court agreed that *Cammarano* and its progeny, rather than *Speiser* and its progeny, applied in the circumstances of the case before the Court. Their reasoning could be highly significant for present purposes.

Justice Blackmun argued, as follows:

> If viewed in isolation, the lobbying restriction contained in sec. 501(c)(3) violates the principle, reaffirmed today, *ante*, at 545, "that the government may not deny a benefit to a person because

> he exercises a constitutional right." [2] Section 501 (c)(3) . . . deprives an otherwise eligible organization of its tax-exempt status and its eligibility to receive tax-deductible contributions for all its activities, whenever one of those activities is "substantial lobbying." Because lobbying is protected by the First Amendment, Eastern Railroad Presidents Conf. v. Noerr Motor Freight, Inc., 365 U.S. 127, 137-138 (1961), sec. 501(c)(3) therefore denies a significant benefit to organizations choosing to exercise their constitutional rights.[3]
>
> The constitutional defect that would inhere in sec. 501(c)(3) alone is avoided by sec. 501(c)(4). As the Court notes, ante, at 544, TWR may use its present sec. 501(c)(3) organization for its nonlobbying activities and may create a sec. 501(c)(4) affiliate to pursue its charitable goals through lobbying. [See Taxation With Representation, op. cit., at page 552.]

---

[2] This quotation from the majority opinion in Taxation With Representation is a succinct description of the holding in Perry v. Sindermann, 408 U.S. 593, 597 (1972), which is a decision in the Speiser line implementing the so-called "principle of unconstitutional conditions."

[3] At this point, the concurring opinion includes the following footnote:

> See Speiser v. Randall, 357 U.S. 513, 518-519 (1958); Cammarano v. United States, 358 U.S. 498, 515 (1959)(Douglas, J., concurring) (denial of business-expense deduction for lobbying is constitutional, but an attempt to deny all deductions for business expenses to a taxpayer who lobbies would penalize unconstitutionally the exercise of First Amendment rights); cf. Harris v. McRae, 448 U.S. 297, 317, n.19 (1980)(denial of welfare benefits for abortion is constitutional, but an attempt to withhold all welfare benefits from one who exercises right to an abortion probably would be impermissible); Maher v. Roe, 432 U.S. 464, 474-475, n.8 (1977)(same).

A vitally important difference between the concurring members and the majority of the Court appears at this point in the concurring opinion.

The majority of the Court, perhaps as a result of the mistaken view pointed out earlier concerning what the restriction on lobbying by section-501(c)(3) organizations actually specified, took the position, noted earlier in this discussion, that a relevant section -501(c)(3) organization would "have to ensure that [it] did not subsidize the sec. 501(c)(4) organization" with which it was affiliated (op. cit., at page 544). By contrast, the concurring opinion argued that:

> A sec. 501 (c)(3) organization's right to speak is not infringed, because it is free to make known its views on legislation through its sec. 501(c)(4) affiliate without losing tax benefits for its nonlobbying activities.
>
> Any significant restriction on this channel of communication, however, would negate the saving effect of sec. 501(c)(4). It must be remembered that sec. 501(c)(3) organizations retain their constitutional right to speak and to petition the Government. Should the IRS attempt to limit the control these organizations exercise over the lobbying of their sec. 501(c)(4) affiliates, the First Amendment problems would be insurmountable. It hardly answers one person's objection to a restriction on his speech that another person, outside his control, may speak for him. Similarly, an attempt to prevent sec. 501(c)(4) organizations from lobbying explicitly on behalf of their sec. 501(c)(3) affiliates would perpetuate sec. 501(c)(3) organizations' inability to make known their views on legislation without incurring the unconstitutional penalty. Such restrictions would extend far beyond Congress' mere refusal to subsidize lobbying. See ante, at 544-545, n.6. [Op. cit., at page 553.]

It is possible to infer from this argument that the Constitution may protect transfers of money from 501(c)(3) organizations to 501(c)(4) affiliates for use in lobbying so long as none of the funds so transferred had derived any benefit from the deduction for charitable contributions. For example, income earned by the 501(c)(3) organization from an unrelated business might be so transferrable.

An argument that a right to make such transfers is constitutionally protected could cite Planned Parenthood v. Arizona, 789 F.2d 1348 (9th Cir., 1986), sum. aff'd., 55 U.S.L.W. 3315 (1986). This case struck down a provision of Arizona law that prohibited any "use of state funds by organizations that offer abortion-related services, even if the state funds themselves are not used for abortion-related services" (id., at page 1350). The Court of Appeals' rationale was that the State had failed to sustain its "burden . . . to show that ear-marking of state funds for non-abortion-related activities and a system of tracing reasonably susceptible to auditing by state officials was not possible to create" (id., at page 1351).

A genuinely aggressive group might even argue that, on the basis of Taxation With Representation, Planned Parenthood, Spieser, and Perry, expenditures made by a 501(c)(3) or 501(c)(4) organization for campaign intervention are constitutionally protected so long as made with funds which had derived no benefit from the organization's exempt status (e.g., after-tax unrelated business income).

In addition to fashioning constitutional defenses for actions undeniably in violation of the plain meaning of the relevant regulations and statutory restrictions, there is another tactic which might be employed by an aggressive group. It was noted earlier in this discussion that the restrictions treat different types of expression and association differently and that circumstances can determine the character of a particular expression as a wholly unrestricted editorial advertisement, restricted "lobbying," or even, in the case of a section-501(c)(3) organization, flatly banned "campaign intervention." Without doubt, restrictions on expression that are not content neutral and restrictions which have the effect of holding First Amendment freedoms of expression and association hostage to the chance acts of legislators or the whims and expediencies of candidates and those whom the news media choose to recognize as serious potential candidates can legitimately arouse the constitutional sensibilities of some. But, wholly apart from their constitutional implications, these situations also afford opportunities for groups interested in extending the frontiers of activity recognized as not in violation of the restrictions.

The greater the number of relevant restrictions and the greater the number of clarifications made by administrative and judicial rulings over the years, the more precise relevant line-drawing becomes. In turn, as the limits become more precise over time, it becomes easier for those subject to them to fashion expression (and other conduct) which comes ever closer to, but remains nevertheless distinct from, proscribed expression (or other conduct). Thus, a gradual process of erosion, of blurring lines of distinction, occurs. This type of process is reflected by early case law interpreting the statutory prohibition against candidate support by labor unions mentioned earlier in this report. For a time, federal courts, led by the Supreme Court's decision in United States v. Congress of Industrial Organizations, 335 U.S. 106 (1948), avoided ruling on the constitutionality of the prohibition by indulging in the fiction that publications which both the plain language of the statute and explicit legislative history suggested were covered by the ban were really "educational" communications to which the ban did not apply. Cf. United States v. Painters Local Union, 172 F.2d 854 (2d Cir., 1949) (August Hand).

An identical fiction (i.e., that certain communications made by the American Birth Control League were not "lobbying" but "educational" communications) was rejected by Learned Hand in what is generally regarded as the earliest case concerning lobbying activities by tax-exempt organizations (i.e., Slee v.

Commissioner, 42 F.2d 184 (2d Cir., 1930)). However, other distinctions between "lobbying" or "campaign intervention" and a particular course of conduct engaged in by a pertinent tax-exempt organization might be drawn.

One final point which, for want of any more logical place to make it, seems appropriately noted at the end of this discussion is that, by analogizing to the case law involving corporate and union political contributions and expenditures, it can be argued that allowing the same individuals to control several affiliated organizations which are maintained as separate organizations in order to maximize constitutionally protected freedoms (and, incidentally, tax benefits) does not exalt form over substance. To support such an argument, the Supreme Court's decision in *Pipefitters v. United States*, 407 U.S.385 (1972), might be cited. That is the decision which sanctioned the maintenance and use of so-called "separate segregated funds" (more commonly referred to colloquially as "political action committees" or PAC's) to conduct political activities on behalf of individuals who are closely associated with corporations and unions.

Robert B. Burdette
Legislative Attorney
American Law Division
March 10, 1987

B. SUBMISSIONS FOR THE RECORD

Statement of the American Heart Association

Founded in 1924 by a group of physicians, who were concerned with the lack of information then available regarding cardiovascular disease. The American Heart Association is now the nation's largest nonprofit, voluntary health organization committed to the reduction of premature death and disability from heart disease, stroke, and related diseases. More than two million American Heart Association volunteers play a vital role in terms of promoting the mission of our organization. We are fonded wholly through private contributions.

Of the current United States population, over 63 million, or one of every four Americans, suffer from some form of cardiovascular disease. As a result, enormous costs are exacted upon our society. A 1979 Surgeon General's report, Healthy People, found that heart disease is the greatest cause of permanent disability claims among workers under 65, and responsible for more days of hospitalization than any other single disorder. The Surgeon General further noted that cardiovascular disease is the principal cause of limited activity for some 2.5 million Americans under age 65.

Cardiovascular disease is the leading cause of death in the United States, accounting for nearly one million deaths annually. This year alone, as many as 1,500,000 Americans will suffer from heart attack, and of that number, about 550,000 will die. Nearly five million Americans alive today have a medical history of heart attack, angina pectoris (chest pain), or both.

In recent years, the American Heart Association has made great strides in accomplishing its goal of reducing death and disability rates related to heart disease. Though cardiovascular disease remains the nation's number one killer, the age adjusted death rates for these diseases have declined 27 percent from 1974 to 1984.

Such success would not have been possible without the scientific research that has provided a greater understanding as the causes, treatments, and means of preventing cardiovascular disease. In 1986, the American Heart Association committed $55.2 million to scientific research. That figure represents nearly one-third of our expenses for the year, making the American Heart Association a leader among national health agencies in the support of research.

The translation of research results into information that may be used by the practitioner to prevent and/or treat cardiovascular disease is another important function performed by the American Heart Association. It is for this reason that the American Heart Association invested $16.1 million in professional education during 1985-1986. In fact, our organization's professional and public education program, which includes the gathering of researchers and scientists at our annual Scientific Sessions for the presentation of abstracts, the publication of nine scientific journals, and the cosponsoring of 12 postgraduate courses, accounts for 27 percent of annual expenditures, exceeded only by expenditures for research.

Communicating this acquired knowledge to local communities accounts for nearly 16 percent of the American Heart Association's annual expenditures. In excess of $30 million was invested last year on the nearly 700,000 employees who participated in our Heart at Work program, on the more than 400,000 pre-school and grade school students who participated in Heart Treasure Chest program, on the nearly 300,000 teenagers who participated in the Save-A-Sweetheart program, and on the 95 million Americans who shopped at grocery stores participating in the American Heart Association's annual food festival.

It is through these complementary activities of research, professional education, and public education, that the American Heart Association hopes to achieve its goal of reducing premature death and disability caused by cardiovascular disease. Yet, we are also aware that our organization will be more successful in our mission if we share our insight and knowledge with those officials who make public policy decisions, including federal and state legislators. It is for this reason that the American Heart Association welcomes the opportunity to submit comments on the political and lobbying activities of nonprofit organizations to the house ways an means Subcommittee on Oversight.

The Subcommittee's invitation to submit comments indicates an interest in the "extent to which tax-exempt organizations undertake lobbying and engage in political activities." At the outset, it should be noted that by law no 501(c)(3) nonprofit entity may engage in "political activities". Relevant 501(c)(3) language provides that exempt organizations must be "organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes . . . ." (Emphasis added.) Such organizations are prohibited from "participat[ing] in, or interven[ing] in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office."

It is for this reason that the American Heart Association does not participate in any "political activities." We do not endorse candidates for public office. We do not supply analyses of the voting records of Members of Congress to our volunteers in an attempt to influence voter preferences. Nor do we fund political advertisements.

It is our belief that any 501(c)(3) organization that participates in these activities is in violation of the law and should be subject to an Internal Revenue Service enforcement action.

Relevant law does permit nonprofit organizations to engage in "lobbying activities." Prior to 1976, in order to retain their nonprofit tax status, all 501(c)(3) organizations were required to meet the Internal Revenue Code's "substantial test," i.e., only an insubstantial portion of an organization's activities could include attempts to influence legislation. However, as part of the Tax Reform Act of 1976, P.L. 94-455, Congress provided nonprofit organizations with an option: They could either continue to operate under the substantial test or they could "elect" to make lobbying expenditures up to a certain threshold level.

The thresholds provided by law are calculated on a sliding scale. Nonprofit organizations that choose to elect may make the following annual lobbying expenditures:

- 20 percent of the first $500,000 of the organization's annual budget;

- 15 percent of the second $500,000 of the organization's annual budget;
- 10 per cent of the third $500,000 of the organization's annual budget; and
- 5 percent of that amount of the organization's annual budget in excess of $1.5 million

However, in no case may a nonprofit organization make lobbying expenditures in excess of $1 million.

Because the American Heart Association makes insubstantial expenditures in its lobbying efforts, the organization has opted to not "elect". Nonetheless, we consider our efforts, which involve an exchange of information and expertise with legislators, to be vital to our goal of reducing the incidence of death and disability related to cardiovascular disease.

An example of an American Heart Association lobbying activity may be illustrative of the important role nonprofit organizations play in the formulation of public policy. Extensive clinical and statistical studies have identified several factors that contribute to one's risk of cardiovascular disease. These factors include heredity, sex, age, race, smoking, high blood pressure, elevated blood cholesterol, and diabetes. Obesity, lack of exercise, and stress are also contributing factors.

Currently, nearly 25 percent of the population is in a high risk category of individuals whose serum cholesterol levels exceed 240 milligrams/deciliter (mg/dl). More than 50 percent of middle-aged Americans have serum cholesterol levels that exceed 200 mg/dl. It is among these individuals that heart attack most often occurs.

That an elevated serum cholesterol level increases one's risk of cardiovascular disease is beyond question. According to the National Institutes of Health Consensus Development Conference Statement, "Lowering Blood Cholesterol to Prevent Heart Disease":

> **Elevated blood cholesterol level is a major cause of coronary artery disease. It has been established beyond a reasonable doubt that lowering definitely elevated blood cholesterol (specifically blood levels of low-density lipoprotein cholesterol) will reduce the risk of hearts due to coronary heart disease.**

(Emphasis added.)

In conjunction with the American Heart Association and other public health groups, the National Heart, Lung and Blood Institute (NHLBI), one of the eleven

National Institutes of Health, has recently embarked on a National Cholesterol Education Program. Through this program, NHLBI hopes to educate both practicing physicians and the general public as to the importance of knowing ones serum cholesterol level as well as the need for treatment when serum cholesterol levels are elevated. Similar activities are ongoing with regard to high blood pressure as part of the High Blood Pressure Education Control Program.

The success of this program, and others like it, would be significantly hampered if funding for NHLBI was suddenly and drastically reduced. It is for this reason that each year the American Heart Association's president, or another high-ranking volunteer, appears before both the House and Senate Subcommittee on Labor-Health and Human Services and Education Appropriations to advocate sufficient funding levels for the programs of NHLBI. In addition, American Heart Association representatives make several personal visits to key member of each of these subcommittees.

Because of our basic concern with the health of the American people, we believe that this is a legitimate and necessary "lobbying" activity for the American Heart Association. To not lobby for sufficient funding for the programs of the National Heart, Lung and Blood Institute would mean that we are not fulfilling our mission to the best of our ability.

An equally necessary lobbying activity for the American Heart Association entails the sharing of research results with Members of Congress. Through our various awards programs including, Established Investigatorships, Clinician-Scientist Awards, Career Investigatorships, Medical Student Research Fellowships, and Grants-in-Aid, the American Heart Association has been able to provide the necessary financial resources to support a broad range of research activities. The results of this research are then shared with public policymakers who ensure that the laws and regulations of our government are consistent with the best scientific knowledge available.

Clearly, the American Heart Association and other nonprofit organizations have a legitimate role to play in terms of public policymaking. We are, therefore, opposed to any attempts to restrict the ability of our organizations to communicate our expertise and knowledge with members of legislative bodies.
This, we fear, is exactly the result that will obtain if the recently proposed IRS regulation on lobbying by nonprofit organizations is finalized. The

proposed regulation, F.R. Doc. 86-29916, establishes a three prong definition for lobbying. As defined, lobbying encompasses any communication that "pertains" to legislation, or seeks or opposes legislation, and reflects a view in terms of the desirability of such legislation, and that is made with either a legislator or an employee of a legislature or with another governmental official that might participate in the development of legislation. Under the proposal, communications that express no view as to legislation would be "deemed" to reflect a view if the communication is "selectively disseminated" to persons reasonably expected to share a common view.

With regard to the proposed regulation's definition of lobbying, the American Heart Association is concerned with the breadth of materials that would be brought within the definition's purview. The very fact that direct lobbying is defined to include communications that "pertain[ ] to legislation being considered... or seek[ ] or oppose[ ] legislation" means that actual legislation need not be referenced to constitute lobbying. Furthermore, the selective dissemination provision of the definition makes clear that a specific view regarding yet to be developed legislation need not even be expressed to constitute lobbying.

An example may be illustrative of the potential implications of this broadened definition. Several Members of Congress have been at the vanguard in promoting legislation that is consistent with the mission of the American Heart Association. Most generally, these Members are not likely to reap political and certainly not financial gain from the position they take on these issues. Instead, their interest is most often based in a deep personal commitment to the health of the American people.

Suppose such a Member of Congress, after introducing legislation requiring packaged foods to label for fat and cholesterol content, turns to an American Heart Association representative and asks to be kept abreast of developments with regard to fat and cholesterol labeling. Several weeks later, an American Heart Association nutritionist forwards to that Member information which suggests the need for sodium content labeling on packaged foods, but in no way does the nutritionist request that the Member introduce legislation on this matter.

Under the proposed regulation the nutritionist's communication could constitute direct lobbying. The communication could be viewed a "pertaining" to legislation. The fact that the communication was with a Member of Congress who had already demonstrated support for nutrition labeling efforts would satisfy the selective dissemination requirement. As a result, an attempt to keep a legislator fully informed as to developments in the scientific community would, under the Internal Revenue Service proposed regulation, give rise to a direct lobbying expenditure.

The American Heart Association does not believe that this is the result intended by the framers of 501(c)(3) or the clarifying language of the 1976 Tax Reform Act. If anything, Congress sought to encourage those nonprofit organizations that had developed a level of expertise with regard to some specific matter to share their knowledge with legislators in order to improve public policymaking.

The House Ways and Means Subcommittee on Oversight must be particularly careful in their review of current law regarding lobbying by nonprofit organizations. The Subcommittee must recognize that attempts to further define the limits of "lobbying" may result in nonprofit organizations being restricted from sharing their expertise with public policymakers. We believe that such a result is neither in the best of interest of Congress nor in the best interest of the American people.

The American Heart Association welcomes the opportunity to further assist the Subcommittee in its review of the political and lobbying activities of nonprofit organizations. We feel certain that Congress will find that the nonprofit sector plays a vital role in our society in terms of research and education. The sharing of knowledge that the nonprofit section has acquired and assimilated is something that should be encouraged and supported.

HOUSE WAYS & MEANS COMMITTEE, SUBCOMMITTEE ON OVERSIGHT

Dear Mr. Chairman:

It is with great interest that we, the Council for Inter-American Security, are following your investigations into the lobbying and political activities of tax-exempt organizations as defined by the Internal Revenue Code for Section 501 (c)(3) groups. Your statement that "Recent events have raised questions about the extent to which tax-exempt organizations are engaged in lobbying and political activities" hits the problem right on the head, namely that many 501 (c)(3) organizations, especially those associated with religious and/or so-called educational causes, have greatly abused and violated IRS statutes and congressional laws pertaining to lobbying. Our research has uncovered a decades-long series of just such violations by groups which have opposed various foreign policies of the U.S. Government.

While much attention has been focused on individuals and groups who have allegedly raised money for the contras or freedom fighters in Nicaragua in ways that may have violated IRS statutes, no attention has been paid to those organizations which have openly and covertly given aid, in many forms, to the Marxist junta in Nicaragua or to the avowedly Marxist guerrilla movements in El Salvador. Senator Armstrong (R-CO) recently added an amendment to SR 162 relating to investigating the tax records of several groups allegedly raising money for the contras. Sen. Armstrong, in his amendment No. 37, also asked that the financial records of the following groups be investigated by the Select Committee on Secret Military Assistance to Iran and the Nicaraguan Opposition: Committee in Solidarity with the People of El Salvador (CISPES); Medical Aid to El Salvador (MAES); New El Salvador Today (NEST); Salvador Medical Relief Fund (SMRF); United States Peace Council (USPC); Communist Party of the United States (CPUSA).

To this list we would like to add several other activist groups and organizations which, evidence shows, have violated the tax-exempt and tax-deductible laws and regulations in regards to lobbying and the laundering of money from tax-exempt groups to non-tax-exempt groups which do lobby.

In order to provide your subcommittee with the information and evidence of lobbying law violations, we have undertaken a survey of the groups involved, including those of Sen. Armstrong's list, and we will show how these groups violate the laws, how much money has been involved where it is possible to ascertain it, and we will show how some of these groups and their predecessors, have been violating these laws since the late 1960's.

Our list will include the Coalition on National Priorities and Military Policy (CNPMP, 1969-1976); Medical Aid to Indochina (MAIC, 1972-1976), its successor FRIENDSHIPMENT (1976-79); Coalition for a New Foreign Military Policy (CNFMP) and its predecessors, the Ad Hoc Committee to Stop Funding the War (1974-75) and the Coalition to Stop Funding the War (1974-75); the Indochina Resource Center (IRC, 1971-76); National Council for Churches (NCC); Clergy and Laity Concerned (formerly Clergy and Laymen Concerned about Vietnam) (CALCAV/CALC); the National Committee to Stop the B-1 Bomber (and two of its key constitute leaders, CALC and the American Friends Service Committee [AFSC]); The Youth Project (TYP), and others.

As we describe each of these organizations and what we feel are violations of the federal laws under consideration by this subcommittee, we will provide numerous documents and other forms of evidence for your consideration (All attached as exhibits).

The first step in our investigation was to find out what had been said about lobbying by tax-exempt groups in order to provide a historical background for what is to follow. Perhaps the best and earliest article we found was that in U.S. News & World Report of Nov. 22, 1971, entitled "'Church Lobby' In Spotlight-

A Look at How It Operates'". Briefly this overview article said that: the orgins of the "church lobby" started back in the early 1960's with the Civil Rights "freedom marches" and attendant lobbying for passage of the Civil Rights Acts of 1964. Other "lobbying" points for churches and other religious organizations focused on the question of voluntary prayer in schools and the "Prayer Amendment".

The article went on to explain the nuts and bolts of the "church lobby" operations which were centered around their Washington-liaison offices. Such offices had staffs ranging from less than five to over several dozen people, with back-up personnel running into the scores of both clergy and laymen.

The article stated that "nearly all claim exemption from taxes, denying that they are 'lobbyists' in the official sense of being engaged primarily in political persuasion".

James M. Dunn, Executive Secretary, Texas Baptist Christian Life Commission, wrote an article in the July 1975 Eternity Magazine, entitled "Lobbying Isn't A Dirty World". In this very frank discussion of lobbying by religious organizations, Dunn wrote: "Be honest about lobbying. Some Christians who are most opposed to the churches involvement in politics are ready enough to fight liquor, gambling, or pornography with political action. They should. But let's be honest and admit that we are lobbyists, attempting to influence legislation.

"In recent years Common Cause and other citizen lobbies have insisted that the public is entitled to know the names and the financial backing of those who work at affecting legislation. Accordingly, laws now demand that those who lobby identify themselves and register. . .

"We, of all people, must be involved-and honest. Let us register, study, educate, campaign, work, lobby and acknowledge it.

"Lobbying isn't a dirty word."

Also of great importance is the feature article "Religious Lobby Gears up for Issues in 100th Congress," (Washington Post, January 17, 1987), which especially concerned U.S. foreign policy towards Central America and South Africa. The article said: "If the past year is any guide, this lobby will be a formidable influence on the 100th Congress. The 99th Congress saw these groups lead the ultimately unsuccessful resistance to U.S. funding of Nicaragua's rebels. . . ."

"'Central America will be the biggest issue, by far, and the question there is whether we could stop American funding to the contras,' said the Rev. Jay Lintner, who directs the Washington office of the 1.6 million member United Church of Christ (UCC)."

Mr. Chairman, as you can see from these articles, covering a period from 1971 to the present, there has been the existence and functioning of a "church lobby" on many issues. The question that we wish to address today is whether tax-deductible money given to a tax-exempt group, such as a church, is being used illegally to aid the Communists in Central America. We believe that this money is being used illegally to lobby the U.S. Congress on legislative matters. However, do the churches want to disclose their finances and resultant activities? Apparently not, Mr. Chairman. An article entitled "Financial Disclosure. Churches Say No" appeared in the June 18, 1977 edition of the Washington Star. Its lead paragraph summed up the article when it said: "Legislation now before a House subcommittee requiring financial disclosure by all organization soliciting charitable contributions by mail is unacceptable to religious organizations, according to testimony by several religious spokesmen, Baptist Press reports."

This opposition by religious organizations to open up their financial ledgers to the public is only part of the cover-up of how tax-exempt and deductible money is being misused.

As an adjunct to this contention of ours, is the fact that historical precedents exist to show how the Communist Party USA (CPUSA) has established aid programs to other Communist governments and groups during the past 35 years, often with direct financing by those Communist governments. The past and present commingling of the role of the Communist Party and of religious lobbying organizations and coalitions will become shockingly apparent in the course of this statement.

First we must take cognizance of the early "aid" groups to Cuba, such as the admittedly Castro-financed propaganda operation known as the Fair Play for Cuba Committee, whose covert Cuban origins were exposed by the hearings of the Senate Internal Security Subcommittee entitled "Fair Play for Cuba Committee" and "Castro's Network in the U.S.: Fair Play for Cuba Committee".

On the other side of the hill, the House Committee held hearings into Castro-backed and pro-Castro operations, usually run by CPUSA members and sympathizers, including the 1962 series known as the "U.S. Communist Party Assistance to Foreign Communist Governments (Medical Aid to Cuba Committee and Friends of British Guiana)." The name "Medical Aid to" will reappear in 1972 as "Medical Aid to Indochina", an aid project connected to and tax-exempt through a Communist Party project known as the "Bach Mai Hospital Relief Fund, Inc.", created by the Party's youth arm, the Young Workers Liberation League. Details of this operation were provided by the late Rep. Larry McDonald (D-Ga) and his team of experienced internal security specialists, in the Congressional Records of February 19, 1976, E 709-10 and of July 5, 1977, E 4809-4810.

During the late 1960's and early 1970's, two sets of lobbying coalitions were set up to influence U.S. foreign policy and our national defense policies. The first group was collectively known as the "Hanoi Lobby" and effectively functioned in two forms from 1967 to 1975 as mass demonstration/protest/lobbying groups, and from 1972-1975 as a specific target lobbying network of thousands of individuals led by a "united campaign" to cut off aid to U.S. allies in Indochina, a maneuever which led to the conquest of that area by North Vietnam.

The mass demonstration type organizations of the 1960's and early 1970's were, from the very start, created by and controlled by U.S. communist parties and their sympathizers. This has been admitted and exposed in congressional hearings held both by the House Committee on Un-American Activities/House Internal Security Committee and the Senate Internal Security Subcommittee. The various "Moblization Committees to End the War in Vietnam" and their successors, were shown beyond any shadow of doubt to be Communist-dominated by these congressional investigations and the subsequent publication of the hearings and additional information in the Congressional Record.

The mass demonstration tactic and heritage of the Hanoi Lobby was passed on to the "Revolution Lobby" through such groups as "U.S. Out of Central America", a tax-exempt group through its Latin America Resource Center and Clearing House; and two specific groups, the National Network in Solidarity with the Nicaraguan People (NNSNP) and the tax-exempt Committee in Solidarity with the People of El Salvador (CISPES). Key members of the Hanoi Lobby reemerged to lead these two groups, and the Communist Party USA has played a key role in establishing both.

The CPUSA has been found by Congress, the Supreme Court, and the FBI to be an arm of the Soviet Union, findings that will have a crucial bearing on CPUSA operations concerning the "Revolution Lobby". The Subversive Activities Control Board, in its reports of April 20, 1953, December 18, 1956, and February 9, 1959, found that:

> "Upon the overwhelming weight of the evidence in the proceeding (Report of April 20, 1953, Docket No 51-101), we find that Respondent is substantially directed, dominated and controlled by the Soviet Union, which controls the world Communist movement. . . and that Respondent operates primarily to advance the objective of such world Communist movement".

Two HCUA reports, expecially that of 1947, titled: "The Communist Party of the U.S. -an Agent of a Foreign Power", stated that the CPUSA is:

> "An organization operating under the centralized discipline subordinated to the Communist Party of the Soviet Union. . . whose basic aim, whether open or concealed, is the abolition of our present economic system and democratic form of government and the establishment of a Soviet dictatorship in its place. . .An organization resorting to deception, evasion, illegal methods, violence, and civil war, method implicit in its revolutionary purpose."

As late as July, 1982, the FBI told the hearings on "Covert Action Operations held by the House Select Committee on Intelligence that:

> "Throughout its history, the CPUSA has been one of the most loyal, pro-Soviet communist parties in the world and has unfalteringly accepted Soviet policy guidance and implemented Soviet policy directives. As previously mentioned, the CPUSA has received substantial financial support for its loyalty and service. . .
>
> "The CPUSA also has directed its major front organizations to support Soviet foreign policy interests. These organizations are often more effective than the CPUSA in reaching and forming coalitions with other organizations because they are not always identified as CPUSA-controlled or pro-Soviet organizations. . .
>
> "The World Peace Council (WPC) is the largest and most active Soviet international front organization, with affiliates in approximately 135 countries. The WPC is one of the Soviet's major instruments for political action and propaganda in the peace movement. . . ."
>
> "The WPC has taken a direct hand in organizing and mobilizing the American Peace movement. Romesh Chandra, President of the WPC, and other WPC officials have headed lobbying delegations that have traveled to the United States in connection with the peace movement. . ."

Mr. Chairman, from January 25-28, 1978, a meeting was held in Washington, D.C. by the World Peace Council Bureau and was called the "International Dialogue for Disarmament and Detente (Testimony of Edward O'Malley, Assistant Director FBI Intelligence Division, July 14, 1982, House Select Committee on Intelligence), which was hosted by a number of church organizations and attended by about a dozen members of Congress. In fact, the WPC publications often feature stories about such meetings and brag about their influence with the U.S. Congress.

The U.S. arm of the World Peace Council, the U.S. Peace Council, was founded by the Communist Party USA in 1979 to expand the Party's reach into other coalitions who would not openly accept the CPUSA for fear of driving off some of their less radical members. Among the key CPUSA members involved with the USPC were Michael Myerson and the late Sandy Pollack, both having extensive international contacts with Communist governments and fronts around the world. Pollack functioned in the same manner as did the COMINTERN agents of the 1930's and 40's, going from country to country and meeting to meeting, helping to set Moscow's strategy into action. She died in 1985 in a plane crash in Cuba on her way to Nicaragua. Her activities as the USPC's "international solidarity coordinator" and as a member of the Salvadoran FMLN-FDR's international front, the "International Solidarity Movement", point up well documented violations of the Foreign Agents Registration Act.

It should also be pointed out that the USPC reportedly has a tax-exempt "Peace Education Fund". This would be a clear violation of IRS regulations as well as of the FARA, and should be investigated by this Subcommittee.

The CPUSA has been able to infiltrate several of the key groups which support either the Communist guerrillas of El Salvador (the FMLN-FDR forces), the Sandinista party in Nicaragua (FSLN), or the "anti-defense lobby" in general, these three groups often being one and the same.

The CPUSA-USPC and NACLA (North American Congress on Latin America), another tax-exempt "educational" organization, held a "National Conference on Nicaragua" in February, 1979 to set up a support group for the FSLN (Sandinistas) in Nicaragua who were in their final fight with the unpopular Government of Anastasio Somoza. They then set up a propaganda/lobbying/financial support group in the U.S. to help keep the Marxists in power when they finally seized it in July, 1979. Stories and documents about this conference can be found in several publications, including J. Michael Waller's Consolidating the Revolution: The Sandinistas's disinformation network in the United States and its effects on Congress; Waller's The Revolution Lobby, a more extensive study on these groups; and James L. Tyson's Target America: The Influence of Communist Propaganda on U.S. Media.

Briefly, the CPUSA/USPC and NACLA, the latter with ties to CIA defector Philip Agee and to the KGB-controlled DGI intelligence agency of Cuba, set up the National Network in Solidarity with the Nicaraguan People, or Nicaragua Network, for short.

The Nicaragua Network, set up a tax-exempt arm known as HAND, Humanitarian Aid for Nicaraguan Democracy, which according to Waller's Consolidating the Revolution book, "channeled funds and supplies to the FSLN guerrilla movement. After the Sandinista victory, HAND continued to operate, as it does today [1986]. The Internal Revenue Service considers HAND a charity, thus donations to the Sandinistas are tax-deductible."

THE COMMITTEE IN SOLIDARITY WITH THE PEOPLE OF EL SALVADOR

Perhaps the greatest Communist Party/U.S. Peace Council success was the joint creation of the Committee in Solidarity with the People of El Salvador in 1980 with the Communist Party of El Salvador. CISPES was to become the propaganda and fund-raising arm of the Communist guerrilla movement (the FMLN) and its political front arm, the FDR. Details of this secret creation of CISPES, came with the seizure in El Salvador of Salvadoran Communist Party agent Farid Handal's notes on his trip to the U.S. which set up this organization. These notes, a translation of which is enclosed for this Subcommittee, give a detailed travel itinerary of who Handal met in the U.S., especially through the Communist Party USA, to obtain aid and support for the creation of CISPES.

This document is a tremendous intelligence gold-mine of just how a Moscow-backed operation is set up, an operation that reached into the halls of the U.S. Congress. The role that tax-exempt organizations played in setting up CISPES should be the target of a major Congressional and IRS investigation.

CISPES had applied for tax-exempt status for itself, according to a CISPES-PAC (Political Action Committee) letter of August 21, 1984, a PAC set up "by people who have worked with the Northwest Regional office of CISPES". CISPES, at their East Coast founding conference, held October 11-23, 1980, made it perfectly clear that their goals were political lobbying and material support for the Communist guerrillas in El Salvador. A copy of this document is enclosed for your attention.

Briefly it states that: "Oppose all forms of U.S. intervention in El Salvador: **Pressure Congress to halt all U.S. Military aid to El Salvador. **Pressure the Administration to halt all U.S. military aid shipments, military cash sales, and military education and training of Salvaorean forces. Support the Salvadorean People in their Liberation Struggle: **Establish a nationally coordinated fund-raising campaign to support the people of El Salvador, including sale of 'Free El Salvador' certificates".

CISPES was founded by the Communist Party of El Salvador and the Communist Party USA, with assistance from a Cuban intelligence officer in New York, then got help from the tax-exempt National Council of Churches -funded group EPICA (Ecumenical Program for Inter-American Communication and Action, est. 1968). EPICA is a small Marxist-oriented group which gets

$19,000 annually from the NCC according to the Capital Research Center study Second Front: Advancing Latin American Revolution in Washington, 1986. When CISPES was created in 1980, they set up three tax-exempt fund-raising organizations: NEST (New El Salvador Today); MAES (Medical Aid to El Salvador); and SHARE (Salvadoran Humanitarian Aid Resource and Education Fund).

Between these three groups, so far, our organization has been able to total up a rough figure of at least $268,000 raised by NEST as of July, 1986 and at least $750,000 by MAES, for a total of over one million dollars. According to a Newsweek article in June 18, 1984, "the guerrillas (in El Salvador) say they received more than $10 million from U.S. solidarity groups in 1981, and that figure is falling off sharply." According to an article "Salvadorean Rebels Bilk Donors in U.S." in the January 23, 1987 Washington Times, this aid from U.S. groups was "conservatively" estimated at $4 million in 1983.

Some sources of money to MAES include $70,000 from a "Give-Peace-A-Dance" affair in San Francisco in 1986, $500 from the Women's Division of the United Methodist Church-1981; over $750,000 from fundraising efforts such as the various letters from Ed Asner and Martin Sheen, and other CISPES-related projects. NEST claims to have raised over $300,000 and SHARE's amount is unknown.

Our organization, in a letter to the IRS in January 8, 1987 wrote that: "We have received reports that CISPES, which has 501(c)(4) status, is raising money for MAES, which is a 501(c)(3). We feel that both organizations are conducting political propaganda and are raising funds under false pretenses", and that "in fact, the purpose of NEST is to provide financial and material assistance to the Farabundo Marti National Liberation Front (FMLN), a paramilitary organization backed by the intelligence agencies of the Soviet Union. We are convinced that NEST's program is to bolster the FMLN's military position in its war against the government of El Salvador through its material assistance program which compliments the military assistance programs of the Soviet bloc."

We also stated that "NEST's direct-mail fundraising is fraudulent because it does not inform the prospective contributor that funds donated will go to the FMLN or FMLN-occupied territory inside El Salvador." (Documents supporting these contentions are enclosed for your consideration).

In regard to Medical Aid to El Salvador, another CISPES project, MAES founder William Zimmerman is well known for his role in aiding Communist governments and movements. He was the founder of Medical Aid to Indochina, a self-avowed aid network for the Communists of Indochina. An MAIC statement proclaimed that: "Medical Aid for Indochina. . .was founded to coordinate efforts to help the people in the Democratic Republic of Vietnam (North Vietnam) and the liberated zones of South Vietnam, Laos, and Cambodia".

Zimmerman was also involved in flying supplies to the Indian occupiers of Wounded Knee, South Dakota. He is also the President of the Executive Secretariat of the FMLN-FDR support group known as the "World Front in Solidarity With the People of El Salvador". Joining Zimmerman in the Front's leadership were the late Sandy Pollack (CPUSA/USPC) and CISPES leader Heidi Tarver.

According to the Congressional Quarterly, John McAward, Human Rights Director for the Unitarian Universalist Service Committee, "citing FDR President Guillermo Ungo as his source, contends CISPES was established to be an FDR mouthpiece in America" (April 24, 1982, p. 898). "CISPES is great people, they have a very effective grass roots, but they were formed by the FDR and FMLN and they get their marching orders from Ungo," McAward said.

COALITION FOR A NEW FOREIGN & MILITARY POLICY

While CISPES functions as an FMLN-FDR support group in the U.S. with ties to both the Communist Party of El Salvador and the CPUSA, another larger coalition group does the actual congressional lobbying. This group, known presently as the Coalition for a New Foreign and Military Policy (CNFMP) or the "Coalition", presents a perfect example of the "united front" concept of the Communist International strategies of the 1930's and 40's. The Coalition claims to have up to 55 member organizations, the greater majority of which are tax-exempt religious organizations and churches.

The Coalition was formed as part of Tom Hayden's anti-Vietnam aid program in 1973. Hayden's original operation, the Indochina Information Project, which got tens of thousands of tax-exempt dollars (Regional Young Adult Project of Northern California), became the Indochina Peace Campaign, and it linked up with lobbying groups to form the "United Campaign/Coalition to Stop Funding the War". Basically, these groups were formalized into a lobbying effort on behalf of Hanoi at the Germantown, Ohio conference in October, 1973, a conference which was delayed due to Hayden's meeting with the North Vietnamese and Viet Cong in Paris the week before.

Once the Hanoi line was established, so too was the anti-aid operation known as "The Hanoi Lobby", and "The Coalition" became its Washington, D.C. arm. From 1975 to the present, the Coalition has used a variety of tax-exempt conduits to obtain their money, with annual budgets running from $143,000 to $350,000 since 1976.

Among the Coalition's tax-exempt conduits have been the United Methodist Church Board of Church & Society (1975-Coalition for a New Foreign Policy); United Methodist Church Board of Church & Society (1977 -Coalition for a New Foreign & Military Policy); 1979 and 1980 -Youth Project: Budget Priorities Project; Fall 1983 -Foreign Policy Education Fund of the Coalition.

In 1976, the Coalition had merged with a similar lobbying group known as the Coalition on National Priorities and Military Policy, and then changed its name from Ad Hoc Coalition for a New Foreign Policy. The older Coalition illegally lobbied Congress on such items as the ABM treaty, defense spending, and manpower cuts, according to their literature. The listing of organizations of the older and newer Coalition are identical, again with church groups in the majority. The older Coalition claimed in a 1975 IRS tax Form 990 that it was formed in 1971, though it was actually created in 1969 according to its earlier literature.

Also, its date of exemption letter was February 7, 1975, listing it as a 501(c)(3), yet its whole purpose, according to its own statements, was to lobby against the defense budget and related items. In 1975, its income was $24,397 and it spent $30,603 as disbursements for tax-exempt purposes.

Thus the older Coalition, headed in practice by Col. Ed King (USA-ret.), lied to the IRS about its activities and violated the terms of its IRS tax-exempt status. In 1976, it merged with the new Coalition which lobbied with tax-exempt conduits to handle their donations, and maintained ties with international communist fronts. Some of their constituent members have been cited by Congress and the State Department as Communist Party USA or Moscow front operations.

One member of the Coalition, in 1976, was the Friends of Indochina Organizing Committee (FIOC), a Hanoi support group formed out of the Indochina Peace Campaign and the church-funded Indochina Resource Center. FIOC was tax-exempt through the Regional Young Adult Project, the same group that funded Tom Hayden's Indochina Information Project. The Indochina Resource Center was funded by the United Methodist Church, Board of Social Concern, United Church of Christ and the United Presbyterian Church. Their tax-exempt budget in 1975 was "roughly $50,000" and both Rep. Clement Zablocki and Edward Herbert told IRC representatives before their various committees that they were lobbying against legislation in violation of their tax-exempt status.

A complete history of the "Coalition" and its constituent parts can be found in the Heritage Foundation study entitled "The

Anti-Defense Lobby: Part III -Coalition for a New Foreign & Military Policy", December, 1979. The Coalition also has ties to the Moscow front, the World Peace Council (WPC).

CLERGY & LAITY CONCERNED/AMERICAN FRIENDS SERVICE COMMITTEE

Two of the most active of the older "peace" groups include Clergy and Laity Concerned (CALC), formerly Clergy & Laymen Concerned About Vietnam (CALV), and the Quaker-based American Friends Service Committee (AFSC), both tax-exempt and deeply involved in lobbying. Today, both groups are members of the lobbying coalition, the Coalition for a New Foreign and Military Policy, and have been active in nearly every anti-Vietnam group to come along since the 1960's.

In 1974, CALC and AFSC joined together in a nationwide campaign to stop the production of the B-1 Bomber, setting up their own group known as the "Stop the B-1 Bomber: Peace Conversion Campaign". CALC sent out a fundraising letter on the Fall, 1975 about this campaign, but it was worded so that it was CALC and the Washington Square United Methodist Church who were involved, with the notation that "Checks made payable to the Wash. Square United Meth. Ch. are tax-deductible".

Another, earlier letter had gone out where CALC wrote "CALC is working with the National Council of Churches on this program. If tax deductibility enables you to make a larger gift, your check may be made payable to the NCC". This use of the National Council of Churches (NCC) was also the method that the far-left DJB Foundation used to give away $2.5 million to the church "because of its sponsorship of Clergy and Laity Concerned About the Vietnam War" (New York Times, May 1, 1975).

The American Friends Service Committee, a tax-exempt charitable organization, had a budget of $9.6 million in the fiscal year September 1975-76 with a gross income of almost $11 million dollars. To the B-1 bomber lobbying effort they gave: "*AFSC: National peace education staff of 30 and full-time regional peace staff in more than 30 offices across the country. A national coordinator committed full time to the B-1 Campaign," and more. "*CALC: Thirty local chapters and staff. A full time campaign staff person and three supportive national staff members."

In 1976, they joined the registered lobbying coalition known as the National Campaign to Stop the B-1 Bomber, another coalition of religious, environmental and leftist activist groups. These same members were also to be found in the lobbying coalition known as the Coalition for a New Foreign and Military Policy, which was not a registered lobbyist. However, both groups enjoyed the tax-exempt status provided by their constituent members and used tax-exempt money to lobby Congress.

Though registered as a lobbyist with the Congress, the National Campaign to Stop the B-1 Bomber contined to use tax-deductible money for its lobbying. This was made evident in a February, 1976 fundraising letter which states: "Still , we are running out of money (we'll be out by mid-March), and your tax-deductible help will be appreciated! (Make checks out to United Church of Christ, earmark for B-1 Campaign, send to 318 Mass. Ave. address)."

According to a 1985 study entitled "The Latin Americanist Establishment", CALC has an annual budget of $450,000, and the AFSC has an annual budget of $15,000,000.

THE YOUTH PROJECT

One of the key methods that lobbying groups have of getting funds is through tax-exempt foundations. Such is the case with the Youth Project. It was the object of a formal complaint by "Citizens for Reagan" in December, 1984 which charged The Youth Project (TYP) with pursuing "certain activities" which "violate certain provisions set forth in Code section 501(c)(3) and regulations promulgated under Code section 501(c)(4), which prohibit tax exempt organizations organized under these Code sections from participating in or intervening in any political campaign on behalf or any candidate for public office and regulations adopted under Code section 170 which prohibit donors from deducting contributions to organizations which engage in certain activities".

Citizens for Reagan, in their complaint filed with the IRS stated: "TYP is designated in the enclosed reply device as the fiscal sponsor of the Central American Peace Campaign (CAPC). The activities of TYP in its sponsorship of the CAPC appear to be both political in nature and to amount to substantial lobbying activities."

The complaint is enclosed for your perusal. Briefly stated CFR charged TYP with encouraging supporters of the CAPC to engage in grassroots lobbying, to "propose a legislative package in Congress", and to make Central America "an election year issue by educating voters about candidate positions and showing them how their votes can promote peace".

In addition to this complaint is an ad that appeared in The Nation magazine on January 29, 1983, by a group or project called "Action For De-Certification", an activity of the Caribbean Basin Information Project. Reportedly the CBIP is affiliated with CISPES and NACLA. The program of the CBIP/Action for De-Certification was stated in the ad as: "I've written my representative demanding they challenge Reagan's certification [of human rights improvements] and aid to El Salvador". Also, the ad states: "It's time to write your representatives in Washington and tell them what you think. And what you feel."

Within a boxed section of the ad, beneath the "I've written my representative..." line, is the following: "Here's my tax deductible contribution. _________(amount) (Make check payable to the Youth Project, a tax-exempt sponsoring organization for the Caribbean Basin Information Project)."

Among the sponsors of this ad are the Coalition for a New Foreign and Military Policy; National Congress on Latin America (NACLA); CISPES; EPICA -funded by the tax-exempt National Council of Churches; Commission on U.S.-Central American Relations; Unitarian Universalist Service Committee; Council on Hemispheric Affairs (COHA); Committee for Medical Aid to El Salvador; Interreligious Task Force; Institute for Food and Development Policy.

All of these groups are either tax-exempt by themselves or enjoy the tax-exempt status conferred on them by another tax-exempt organization as is the case of EPICA and the National Council of Churches. Several of them have been funded by grants either directly from The Youth Project or by grants from funds administered by The Youth Project, such as the Institute for Food & Development Policy and the International Center for Development Policy run by former U.S. Ambassador to El Salvador Robert White.

White's ICDP received $20,000 in FY 85 from the Circle Fund which "is advised for the Youth Project by David Hunter". Part of the funding was for "ICDP/Investigation Project", which is probably the effort by White's Commission on Central America that has been looking for drug-running and illegal arms smuggling by either the so-called "contras" of Nicaragua or their supporters in the U.S. According to the New York Times of February 24, 1987, this Commission was paying part of the costs of a joint investigation by itself and by members of the staff of Sen. John Kerry (D-Mass).

This violation could fall under IRS Revised Procedure 72-39 which forbids a person giving money to a tax-exempt group as a tax-deductible donation when they know that it is going to be used in violation of their IRS tax-exempt status. This is called "laundering" and was used by General Motors heir Stewart Mott in 1974 as a means of giving $90,000 to an anti-Vietnam lobbying group. According to Fortune magazine of March, 1974, Mott did the following: "Through the Board of Church and Society of the United Methodist Church, he has contributed $90,000 to the Coalition to Stop Funding the War, which is unhappy with the continuing U.S. involvement in South Vietnam (it wants to end all military aid to the country)."

Thus this method of laundering tax-exempt/tax-deductible money through tax-exempt intermediaries to a tax-exempt lobbying organization has been used in the past.

In summation, Mr. Chairman, what we have with the "Revolution Lobby" and their support network in the U.S. is a wholesale abuse of both the tax-exempt and tax-deductible statuses of donor and recipient groups who also have violated their own tax-exempt statuses by illegally lobbying with tax-exempt money, failing to register with the Clerk of the House and Senate as required by the Lobbying Act of 1946 or Tax Reform Act of 1976, and also of failing to register as an agent of a foreign power as required by the FAR Act.

A fullscale hearing on these allegations and evidence of abuse and violations of these laws should be held, hopefully by this Subcommittee, so that everything can be laid on the table, in full view of the Congress and the American public. We are sure that the evidence we can present will sustain our claims of gross abuses by the enemies of America and their supporters, and those who have unknowingly contributed to these violations of the law should be made aware of what is happening to their money.

We thank you for your time and consideration of our presentation. (Attached are the exhibits to document our testimony.)

March 18, 1987

Statement of

DALLAS SALISBURY

President
Employee Benefit Research Institute
and the Employee Benefit Research Institute
Education and Research Fund

The Employee Benefit Research Institute ("EBRI") is a nonprofit, nonpartisan public policy research organization based in Washington, D.C. Established in 1978, EBRI provides educational and research materials concerning employee benefits to employers, employees, retired workers, public officials, members of the press, academics, and the general public. It is exempt from federal taxation under Internal Revenue Code Section 501(c)(6).

The Employee Benefit Research Institute Education and Research Fund is a separate, segregated fund maintained by EBRI. The Education and Research Fund conducts analysis and research on important topics relating to employee health, welfare, and retirement policies, and publishes the results of that research. The Education and Research Fund is exempt from federal taxation under Internal Revenue Code Section 501(c)(3).

Neither EBRI nor the Education and Research Fund engage in lobbying or political campaign activity. They do conduct research and publish the results of that research on important issues in the employee benefits area. The topics considered by EBRI -- employee pensions, health care, and other benefits -- are frequently the subject of legislation. EBRI is concerned that the perceived abuses of some organizations that engage in lobbying or political campaign activity may prompt Congress to impose strict new rules limiting the ability of all tax-exempt organizations to conduct research or educational activities on topics that may be the subject of legislation.

Nonprofit organizations are an invaluable source of information for Congress, the Executive Branch, and state and local governments. Such organizations conduct research and analysis on a number of public policy issues of concern to Congress and other governmental agencies. The Congress would be doing itself a great disservice if it were to cut off these important sources of information through overly restrictive definitions of lobbying and limits on contacts between public charities and the government.

Robust and free participation by nonprofit organizations in the consideration of social policy issues is essential for a full and informed exposition of possible approaches to a problem. Nonprofit organizations provide an opportunity for the presentation of full and more complete information on matters of interest to Congress. Absent this involvement, the record before Congress would be less complete. Furthermore, restricting the ability of tax-exempt organizations to express their views will help to isolate the government from the governed.

A free society is best served by the availability of the widest number of sources of information. The current statutory rules governing lobbying by tax-exempt organizations strike a delicate balance between the interests of the widest possible availability of information and the desire of Congress not to subsidize political activity through the granting of tax-exempt status.

EBRI responds to numerous requests from Congressmen and their staffs for information concerning employee benefit issues. Other tax-exempt organizations provide Congress with invaluable information concerning their areas of expertise. Unduly restrictive definitions of lobbying and strict limits on lobbying activities by tax-exempt organizations would force organizations such as EBRI and the Education and Research Fund to drastically restrict the dissemination of the information which they gather.

A number of organizations are presently charged by the media with abusing the limits on lobbying and political campaign activities by exempt organizations. The alleged abuses of the few should not lead Congress to impose unduly restrictive rules on the thousands of organizations that obey current law. Increased enforcement of existing limits on political campaign activities and lobbying by tax-exempt organizations should address the vast majority of claimed abuses without adversely affecting other entities.

The news media are also currently carrying numerous stories about affiliated tax-exempt organizations that have played fast and loose with the limits on activities by organizations recognized as exempt under different subsections of Internal Revenue Code Section 501(c). Most organizations, including EBRI and its Education and Research Fund, recognize that different organizations in such affiliated groups must obey different restrictions on their activities and must separate their funds and keep separate books and records.

Activities in pursuit of common interests often may be carried out by organizations that are recognized as exempt under differing subsections of the Internal Revenue Code. As long as such organizations properly restrict their activities, separate their funds, maintain adequate records, and properly account for their expenses, there should be no restrictions on their being related to other tax-exempt organizations. Merely because some organizations may attempt to abuse their affiliation with other entities is not a basis for restricting the affiliation rights of other organizations. It is at least questionable whether such restrictions would be constitutional since they would restrict the First Amendment rights of the affected organizations. See Regan v. Taxation With Representation of Washington, 461 U.S. 540, 553 (1983) (Blackmun, J., concurring).

Many tax-exempt organizations might benefit from some clarification of the current rules governing lobbying. Such carefully considered clarification should impose no new undue burden. The alleged abuses by some organizations may be adequately addressed by more vigorous enforcement of the current limits on lobbying and political campaign activities of tax-exempt organizations. I strongly urge Congress to avoid any unwarranted additional restrictions on the lobbying activities of tax-exempt organizations.

COMMENTS OF THE POLICE EXECUTIVE RESEARCH FORUM

ON

LOBBYING AND POLITICAL ACTIVITIES OF TAX-EXEMPT ORGANIZATIONS

The Police Executive Research Forum is pleased to enter this statement for the record of the Subcommittee on Oversight, Committee on Ways and Means, U.S. House of Representatives, in connection with its examination of the lobbying and political activities of non-profit organizations.

The Police Executive Research Forum is a membership organization of police chiefs from the nation's largest jurisdictions who have a record of progressive policing in their departments. The jurisdictions served by Forum members comprise 25% of the nation's population. Through research, technical assistance, scholarly debate and strong national leadership, the Forum seeks to achieve its "exempt purposes" of professionalizing the field of policing and promoting innovation in the criminal justice system. To a limited extent, the Forum also engages in lobbying to further this goal.

It is well known that police are not in the "lobbying business" and generally have very diverse perspectives on political issues. Occasionally, however, an issue arises which impacts on public safety to such an extent that the police put aside their political differences and speak with a collective voice on national policy. Before further discussing the lobbying activities of the Forum and the Forum's position on the issue of lobbying by non-profit organizations, a description of the Forum's tax-exempt status, funding sources and related organizational structure is provided.

The Forum is a 501(C)3 organization, and is one of the 1% of these organizations that has elected the expenditure test of section 501 (h) and 4911 of the Tax Reform Act of 1976, section 1307. As such, the Forum maintains a careful accounting of the lobbying nontaxable amount and the grass roots nontaxable amount that constitute permissible expenditures each year, in order to maintain the expenditure rate below that which would require payment of the 25% excise tax described in 4911 (a)(1),(b)(1).

The Forum has never exceeded the percentage of "exempt purpose expenditures" that is permissible each year for the purpose of influencing legislation, under the "safe haven rule". Like many of the 501(C)3 organizations, the Forum is also audited each year by one of the major U.S. accounting firms, and Forum staff are briefed by legal counsel regarding permissible lobbying activities under 501 (h). In addition to the Forum's compliance with the Internal Revenue Code, the one Forum employee who engages in part-time lobbying regularly reports on lobbying activities, in order to maintain compliance under the Federal Regulation of Lobbying Act. The Forum does not maintain an affiliated 501 C4 organization.

The Forum's organizational structure consists of divisions for Research, Management Services, Administration and Accounting, with varied funding sources based on the functions within each division.

Grants provided by several agencies within the U.S. Department of Justice are a primary source of funding for Forum research projects, such as the 1.1 million dollar grant from the National Institute of Justice, which funded development of problem-oriented policing. This approach has assisted in the solution of numerous substantive community problems in Newport News, Virginia, and Baltimore County, Maryland, prompting the Institute to sponsor additional research in St. Petersburg, Clearwater and Tampa, Florida. Other grants have allowed the Forum to conduct extensive research on subjects such as improving the police response to the mentally ill, controlling career criminals, strategies for reducing drug-related crime, and abuse of the elderly.

The Management Services branch provides technical assistance and conducts management studies of individual police agencies, at the request of the agency and funded partially by the Ford Foundation and also by short-term contract with the jurisdiction involved. These studies focus not only on the efficiency of the agency, but also on use of proper standards in the delivery of police services, promoting the standards outlined by the Commission on Accreditation for Law Enforcement Agencies.

The Administration and Accounting branches are funded primarily through a general purpose grant provided by the Ford Foundation and indirect cost funds from research grants.

As individuals who must serve on the "front lines" in their profession to enforce existing law, frequently risking their own lives, legislation is often of great significance to police officers. At times, legislation impacts the safety of the police or the public to such an extent that the Forum is called to move beyond the role of informing/educating the criminal justice community and the membership about pending legislation, to a position of opposition or advocacy regarding a particular bill.

Although a majority of Forum legislative involvement has fallen under the "technical assistance to a governmental body" exclusion from the definition of "influencing legislation" in code 4911 (d)(2),(3), (as has, for example, our Testimony before the House Judiciary Committee Subcommittee on Crime, concerning the Armor-Piercing Bullet Bill, which sought to ban the Teflon-coated bullets that pierce the vests worn by police officers) occasionally our involvement has moved beyond that exception.

In an effort to protect the Federal Firearms Tracing Program and to balance the legitimate concerns of hunters with the need to maintain sensible gun regulations provided in the Gun Control Act of 1968, the Forum stepped into the realm of lobbying last year by opposing the McClure-Volkmer Gun Decontrol Bill and supporting the Judiciary Committee's "Law Enforcement Alternative" Bill, H.R. 4332.

Discussion of this lobbying effort illustrates the precautions taken by the Forum to ensure compliance with 501 (h) and 4911 regulations. First, neither the Forum nor the Law Enforcement Steering Committee entity engaged in fund raising activities or accepted any contributions "earmarked" for lobbying, concerning this legislation. All Forum staff time, benefits, overhead costs, phone bills, printing and postage related to the lobbying were recorded in a separate cost center, and these expenditures were covered by funds obtained from general Forum publication sales as well as general contributions from another non-profit 501(C)3 organization which were also not "earmarked" for lobbying.

The Forum does not engage in political campaign activities or endorse candidates. The Forum also never provides ratings of candidates in connection with their positions on selected issues. Additionally, Forum mailing lists have never been provided to members of Congress or any candidate for political office, for the purpose of reaching a voting constituency. Lobbying activity is limited to legislation of direct interest to Forum membership within their role as the nation's leading police executives.

Additionally, in April of 1986 an extensive legal document addressing lobbying regulations was prepared by counsel who represent the Forum, to be used by Forum employees as a guideline regarding all future legislative involvement and cost allocation. Preparation of this document involved a significant financial investment on the part of the Forum, and represents one of our many good faith efforts at compliance with lobbying regulations.

The extensive precautions taken by Forum staff for compliance with 501 (h) standards demonstrate the high priority, and what is also viewed by police executives as the necessity, of mantaining the privilege to engage in limited lobbying activities under 501 (h).

Given the fact that the U.S. General Accounting Office has testified that violations of the 501(C)3 regulations are far from widespread, the Forum welcomes stepped-up enforcement efforts of current law as a potential solution, and an increase in IRS resources for ensuring compliance, rather than immediate institution of further restrictions on lobbying privileges. Taking into consideration the record of good faith efforts at compliance that have been demonstrated by organizations such as the Police Executive Research Forum, it is the Forum's position that the drastic measure of further restricting lobbying privileges is not warranted, but any organizations found to be in violation of existing law should be severely penalized.

The Forum is well aware of the problems that can arise for Members of Congress regarding special (or "single issue") interest group pressure and the proliferation of PACs. The Forum has confronted, first hand, the power of such groups in our effort to promote responsible gun legislation and other crime control legislation. As Andrew S. McFarland contends, in his well recognized theory of minority faction, special interest groups dominate political decisionmaking, which in turn hinders the ability of government officials to devise sound national policies. But he notes that various important countervailing forces do arise to challenge these special interests, such as social movements and "public interest lobbies." He also notes the potential that public interest lobbies have for creating more responsible legislation by counteracting the special interest groups and making the national government more representative of broad public interest.

If further restrictions on the lobbying activities of non-profit organizations must be imposed in the future, McFarland's view illustrates the need for an exception to be made for the limited lobbying activities of public safety officials. Police executives view themselves as an additional arm of government, and only recently have they begun to have a strong collective voice (through groups such as the Law Enforcement Steering Committee, composed of 11 national police organizations) in advocating responsible federal gun legislation and other crime control legislation on which they share technical expertise, and which they must ultimately be the first to enforce. There is no greater public interest than public safety, and therefore "public interest lobbies" such as the police should be allowed to continue their limited lobbying efforts designed to create more responsible legislation impacting on the criminal justice system.

TESTIMONY
before the
OVERSIGHT SUBCOMMITTEE
of the
HOUSE WAYS AND MEANS COMMITTEE
by
U.S. REP. PATRICIA SCHROEDER (D-CO)
March 12, 1987

You have probably already heard from many tax exempt, non-profit organizations concerning the recent rule proposed by the Internal Revenue Service. But believe me, there are ten times the number of organizations who are just now learning of it. And they are mad!

The proposed rule, published the day after the November 4 elections, would reclassify many ordinary non-profit activities as "lobbying", a term that the proposed rule defined as wide as the Mississippi. The rule sets a 5% threshold on what a non-profit can spend to "lobby" before it becomes tax liable and in jeopardy of losing its tax exempt status, bulk mailing privileges, and foundation grants. The rule also provides an expenditure test, to account for a group's spending habits, so complicated it makes the new W-4 form look preschool level.

Free speech arguments notwithstanding, this proposal would chill and freeze many benign activities of service and educational organizations. Sending out newsletter with legislative updates to a group's membership can be defined as lobbying, subject to the expenditure test. Circulating a voting record would be lobbying. The merest mention of legislation in any fundraising, membership, or educational material could lead to the expenditure test. Expressing an opinion about legislation not even thought of would be considered lobbying. And an organization under sunset review by a state legislature could not lobby on its own behalf without facing the expenditure test.

These definitions and interpretations will torpedo what non-profit organizations are mostly complaining about communication. Among the services that organizations provide to their clients is information about public policy that may help or hurt their clients. Our open democracy allows for public participation in the public policy process and participation can only come after information in given.

Organizations in my district, Denver, Colorado immediately call for repeal of the new rule once they comprehend its effect. I have been asked by several to include them in my testimony so you can better gauge the reaction. They include the Colorado Association of Homes and Services for the Aging, the Institute of Gerontology, The Directors of Volunteers in Agencies (DOVIA), the Denver Board for the Developmentally Disabled, the National Association of Social Workers, and the Women's International League for Peace and Freedom. This by no means completes the list. They are just the ones that asked me to mention their names. You and the IRS, no doubt, will hear from scores of other Denver organizations.

Denver is home to at least 25 foundations that provide operating funds and support to non-profits. The regulation would restrict the types and amounts of grants and donations non-profits can receive. The new rule would also restrict the advocacy activity of private foundations and to deny them tax deductions for grants to groups later used for lobbying activities.

These foundations and non-profits, remember, serve an essential role in today's society. They fill the void in human services that federal budget cuts left. Services to the old, infirmed, handicapped, and those with no voice in Congress have to be maintained by this public-private-volunteer partnership. The Reagan Administration once sang songs of praise for volunteers. Now it wants to sing funeral dirges.

Denver beats the national average in giving time and money to charitable groups, according to a recent survey. This giving and sharing will dry up as organizations lose their tax exempt status, making any donation fully taxable. Volunteer work would be discouraged since many volunteer jobs include information dissemination, or what the IRS would call lobbying.

There is no rational way to fine tune this proposal, amend definitions, or set up appeal mechanisms. The IRS can't afford to enforce these regulations, anyway. The only resource is to table this proposal indefinitely. I hope you agree and can convince the IRS to do the same.

ONE HUNDREDTH CONGRESS

AL SWIFT, WASHINGTON, CHAIRMAN

CHARLES ROSE, NORTH CAROLINA
LEON E. PANETTA, CALIFORNIA
MARY ROSE OAKAR, OHIO
WILLIAM (BILL) CLAY, MISSOURI
JIM BATES, CALIFORNIA
TONY COELHO, CALIFORNIA

WILLIAM M. THOMAS, CALIFORNIA
BARBARA F. VUCANOVICH, NEVADA
PAT ROBERTS, KANSAS
BILL FRENZEL, MINNESOTA

KARL J. SANDSTROM, ELECTIONS COUNSEL
KATHRYN ERICKSON JARVIS, STAFF DIRECTOR

Congress of the United States
House of Representatives
Committee on House Administration
SUBCOMMITTEE ON ELECTIONS
802 House Annex 1
WASHINGTON, DC 20515-6157
(202) 226-7616

Testimony of Congressman Al Swift
Subcommittee on Oversight
Committee on Ways and Means

I want to thank the Committee for the opportunity to submit testimony on this very important subject. As Chairman of the Subcommittee on Elections, I share your concern that the tax code should not be allowed to become a vehicle for circumventing our campaign finance laws. The integrity of our election laws is dependent upon maintaining strict separation between activities that can be carried on as charitable, educational, or religious and those that fall within the ambit of the Federal Election Campaign Act. Recently, three trends have become apparent that threaten this separation.

First is the use by prospective candidates of tax exempt educational organizations to further their political ambitions. There are significant incentives under existing law for a person considering running for federal office, particularly the Presidency, to delay becoming a candidate and to instead create an educational organization to underwrite his or her exploratory activities. By doing so, the would-be candidate avoids the disclosure provisions of federal election law. Consequently,the public is left largely unaware of the nature and scope of the person's activities. Nor is the source of financing available to public inspection. The light which the Federal Election Campaign Act seeks to shed on our political processes is blocked.

But it is not just the disclosure provisions of the law that are being tested. The contribution and expenditure limitations of our campaign law also come under increased pressure. The recharacterization of inherently political activities as educational holds substantial potential for permitting candidates to avoid the limits of the law. Ingenious lawyers are employed to assure that the organization functions in the most politically advantageous manner while allowing its activities to be characterized as educational, religious or charitable. Critical travel, research and even polling is recharacterized to the aspirant's advantage. Candidates unwilling to resort to this dodge find themselves at a competitive disadvantage.

A bad situation is made worse by the fact that the taxpayer is picking up the tab. Because of their purported educational, religious or charitable nature, some of these organizations are eligible to receive tax deductible contributions. The political neutrality of the tax code is sundered by the advantage that deductibility confers upon such organizations. These organizations become favored players in the political process. Corporations which otherwise would be prohibited from participating in federal elections find an advantageous route into the political process. Individuals who otherwise would be able only to make limited non-deductible contributions find themselves able to make unlimited deductible contributions. The abuses that led to our campaign finance laws resurface.

I believe the situation is in need of correction. I am of the view that new restrictions on the ability of public office holders and persons seeking public office to establish, maintain or control tax exempt organizations are necessary. Such restrictions can be narrowly crafted so as not to impinge on legitimate activities. As Chairman of the Subcommittee on Elections, I am willing to do whatever I can to assist you in such an effort.

The second trend that I find to be disturbing is the blurring of the line between 501 (c) (3) and (c) (4) organizations that current law permits. Organizations qualifying under 501 (c) (3) of the tax code are eligible to receive tax deductible contributions. These organizations are largely prohibited from engaging in lobbying and political activities. On the other hand organizations qualifying under section 501 (c) (4) are not entitled to receive tax deductible contributions, but are essentially free to engage in lobbying activities and some political activities. Problems arise when their activities are not kept distinct. Allowing a 501 (c) (3) organization to operate or be affiliated with a 501 (c) (4) invites problems. The organizations can come to have no more than paper separation. The prohibition on political and lobbying activities by 501 (c) (3) organizations is easily rendered ineffective.

As recent news accounts suggest, 501 (c) (3) organizations can become the engine that drives the political propaganda machinery of 501 (c) (4) organizations. Problems of cross subsidization are inevitable when the organizations are not required to be truly separate. Again I would suggest that legislation could be drafted that would construct a meaningful wall between such organizations. Such legislation would leave to each its legitimate sphere of activity while assuring that an organization did not stray beyond its legitimate confines.

One last and related trend is the increasing difficulty of distinguishing between political committees and affiliated tax exempt organizations. I particularly have in mind the problems that arise when political organizations share staff and expenses with tax exempt organizations. To prevent political campaigns from being conducted under the guise of tax exempt activity, serious consideration should be given to requiring tax exempt organizations to operate wholly independently of any political committee, organization or candidate. The sharing of staff, mailing lists and expenses between such organizations should be barred. Such a change would enhance the disclosure provisions of federal election law. Full and complete disclosure of election related activity would be facilitated.

A fundamental tenet of our campaign finance laws is that political activity should be open to public scrutiny. Therefore it is incumbent that the tax code does not become a shelter in which political participants can hide their activities. I commend your Committee for your efforts to assure that the integrity of our election laws is not violated by misuse of the tax code.

STATEMENT
of
UNITED STATES CATHOLIC CONFERENCE
before the

SUBCOMMITTEE ON OVERSIGHT

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

Submitted by:

Mark E. Chopko
General Counsel

Deirdre Halloran
Associate General Counsel

United States Catholic Conference
1312 Massachusetts Ave., N.W.
Washington, D.C. 20005
202/659-6690

March 27, 1987

The United States Catholic Conference (USCC) submits this statement for the record of the hearings on the lobbying and political campaign activity restrictions of the Internal Revenue Code applied to activity of tax-exempt organizations. USCC is a nonprofit membership corporation of which all active Catholic Bishops of the United States are members. USCC promotes the pastoral teachings of the bishops in such diverse areas as education, social welfare, health and hospitals, youth activities, communications, and immigration and refugee assistance. USCC is exempt from federal income tax pursuant to section 501(c)(3) of the Internal Revenue Code of 1986 ("Code"), and holds a group tax-exemption ruling, reaffirmed annually, that establishes the exemption under section 501(c)(3) of the Code of thousands of Catholic organizations listed in the Official Catholic Directory.

USCC and the numerous Catholic organizations covered under the USCC group exemption ruling are subject to both the lobbying and political campaign activity restrictions of section 501(c)(3). It is the political campaign activity restriction, however, as vaguely defined and applied by IRS, that has created the uncertain atmosphere where statements in moral and public policy debates are challenged as illegal action. Although we will summarize the general application of the lobbying restrictions to churches and religious organizations, our primary focus for the Subcommittee will be to address ways to rectify the political campaign activity restrictions of section 501(c)(3).

At the outset, we would like to address any negative inferences that may have been drawn from the fact that USCC declined the Subcommittee's request to testify at the March 12 and 13th hearings. USCC made the decision not to testify because of its involvement in a pending lawsuit, Abortion Rights Mobilization, Inc. et al v. Baker,[1/] in which pro-abortion groups and individuals challenge its tax-exempt status and that of the National Conference of Catholic Bishops ("NCCB"), as well as other Catholic entities. The plaintiffs charge that the Catholic groups have engaged in partisan political activity because of the Church's opposition to the legal status of abortion, which is deemed immoral by the Roman Catholic Church. Plaintiffs claim that IRS's alleged failure to curb such activities is a violation of section 501(c)(3) of the Code and the establishment clause of the First Amendment. They demand that the district court compel IRS to revoke the tax-exempt status of USCC and NCCB, to assess and collect all taxes due on revocation, and to cause USCC to notify contributors that contributions are no longer deductible under section 170. Although no longer parties to this lawsuit, USCC and NCCB face costly and burdensome discovery.

Both the United States and USCC challenge the standing of the plaintiffs to seek, and a court's jurisdiction to entertain, relief arising out of the

---

1/ No. 80 Civ. 5590 (RLC) (filed S.D.N.Y. October 2, 1980).

IRS's treatment of *another* taxpayer. We have been unable to obtain dismissal on that obvious point.[2] The United States has been unable to obtain relief by way of the extraordinary writ of mandamus.[3] Thus, USCC and NCCB risked a contempt citation in order to appeal the district court's jurisdictional rulings to the court of appeals. USCC and NCCB were held in contempt on May 8, 1986.[4] An expedited appeal was argued on June 25 and all penalties--$50,000 per day for each organization--were stayed, pending that appellate decision.[5] There has been no decision. Although confident that plaintiffs will not prevail on their point that there is an ongoing pattern of prohibited political campaign activity, USCC and NCCB believe that the IRS's treatment of one taxpayer is simply not the business of another.

I. *Lobbying Restriction*

Section 501(c)(3) of the Code provides, in relevant part, for exemption from federal income tax of organizations that are

> [o]rganized and operated exclusively for religious, charitable...or educational purposes...no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation ... and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

It is important to distinguish between lobbying and political campaign activities and their different treatment under the Code.

The section 501(c)(3) lobbying activity restriction is not absolute. Rather, a charitable organization risks loss of exemption under section 501(c)(3) only if more than an insubstantial part of its activities consists

---

2/ *See* *Khalaf v. Regan*, 85-1 USTC ¶ 9269 (D.D.C. 1985) (dismissed on standing grounds); *American Society of Travel Agents, Inc. v. Blumenthal*, 566 F.2d 145 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 947 (1978).

3/ The court of appeals denied relief without argument and without opinion. In re Baker, 788 F.2d 3 (2d Cir.), *cert. denied*, 107 S.Ct. 256 (1986). No view on the merits may be implied from that action.

4/ 110 F.R.D. 337 (1986). The court's opinion is riddled with factual errors.

5/ In re U.S.C.C., No. 86-6092 (*filed* 2d Cir. May 12, 1986) (sub judice).

of attempts to influence legislation.[6] The restriction applies to both direct and grassroots lobbying, and has been interpreted to include even time spent in support activities preparatory to the development of a legislative position.[7] Much controversy has attended the issue of what constitutes an "insubstantial" amount of legislative activity, since neither the Code nor the Regulations define that term.[8]

In response to complaints about the vagaries of the substantiality test, Congress enacted sections 501(h) and 4911 of the Code as part of the Tax Reform Act of 1976. These provisions permit electing public charities to replace the substantiality test and spend a limited percentage of their annual charitable expenditures on influencing legislation, without adverse tax consequences. USCC opposed the original drafts of the lobbying election provisions in testimony presented by Joseph Cardinal Bernardin, then General Secretary of the USCC, before the Ways and Means Committee. Briefly, USCC opposed H.R. 13720, an earlier version of the lobbying expenditure provisions, because (1) it would interfere with the Free Exercise rights of churches and other religious organizations, (2) its standards for regulating legislative activity would require detailed scrutiny and supervision of the activities of churches, e.g., through reporting requirements and examination of books and records, and (3) its restrictions, notably those regarding "affecting public opinion" and direct communications with members, were offensive to churches and largely unworkable given the realities of modern media.

6/ For this purpose, Treasury Regulations define "legislation" as any "action by the Congress, by any State legislature, by any local council or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure." Treas. Reg. §1.501(c)(3)-1(c)(3)(ii).

7/ See Kuper v. Commissioner, 332 F.2d 562 (3d Cir.), cert. denied, 379 U.S. 920 (1964); League of Women Voters v. United States, 180 F. Supp. 379 (Ct. Cl.), cert. denied., 364 U.S. 822 (1960). Among the activities considered not to constitute attempts to influence legislation are presentations of testimony at the written invitation of congressional committees, and distribution to the public of the results of non-partisan analysis, study, or research. See Rev. Rul. 70-449, 1970-2 C.B. 111; Rev. Rul. 64-195, 1964-2 C.B. 138.

8/ The scant judicial precedent does little to resolve the issue. Seasongood v. Commissioner, 227 F.2d 907 (6th Cir. 1955), established that less than 5% of an organization's time and effort devoted to legislative activities was not substantial, while Haswell v. United States, 500 F.2d 1133 (Ct. Cl. 1974), cert. denied, 419 U.S. 1107 (1975), found that between 16% and 17% of an organization's budget spent on legislative activities was substantial. Thus, the "safe" range under the substantiality test would appear to be somewhere between 5% and 15%, but even those determinations require analysis of all relevant facts.

USCC requested an exemption for churches both from the provisions of what became section 501(h) and the general lobbying limitations of section 501(c)(3). In response to the concerns raised by USCC and other church groups, section 501(h)(5) listed churches, conventions or associations of churches, integrated auxiliaries of churches, and members of affiliated groups among the organizations that were disqualified from making the lobbying election. Congress also added the "no inference" provision of section 501(h)(7), which stated that if an organization is disqualified from making the election or has not made the election, "nothing in section 501(h) or section 4911 shall be construed to affect the interpretation of the phrase 'no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation' under subsection (c)(3)."[9]

Thus, USCC and most of the organizations covered in its group exemption ruling are not eligible to make the lobbying expenditure election, and remain subject to the substantial part test. USCC observes, and urges organizations covered under its group exemption ruling to observe, the limits of the section 501(c)(3) substantiality test, to the extent its parameters have been defined, even though USCC has serious reservations about the constitutionality of the lobbying restrictions in view of their infringement on the Free Exercise rights of churches and religious organizations. Regan v. Taxation with Representation [10] failed to resolve USCC's concerns, since it did not address any Free Exercise arguments.

II. Political Campaign Activity Restriction

Unlike lobbying, political campaign activity is subject to a prohibition written in terms that the IRS has construed as absolute. Section 501(c)(3) forbids participation or intervention in a political campaign on behalf of a candidate for public office (including publishing or distributing statements). Under the Regulations, this prohibition is extended to both direct and indirect participation or intervention in a political campaign, on behalf of or in opposition to a candidate.[11] The Regulations further provide that such activities include, but are not limited to, the publication or distribution of written or printed statements or the making of oral statements on behalf of or in opposition to a candidate.[12] In addition, charitable organizations may not provide financial or other forms of campaign support - such as volunteers, facilities or similar assistance - nor may they establish or support a political action committee ("PAC").[13]

---

[9] I.R.C. § 501(h)(7).

[10] 461 U.S. 540 (1983).

[11] Treas. Reg. § 1.501(c)(3)-1(c)(3)(iii).

[12] Id.

A. Statutory Analysis. In August 1986, USCC submitted to Robert I. Brauer, Assistant Commissioner for Employee Plans and Exempt Organizations, Internal Revenue Service National Office, its analysis of whether the IRS interpretation of the political campaign activity restriction accords with the language and intent of the statute. We have attached a copy of this analysis (Exhibit #1) for the Subcommittee's consideration. One of the major flaws of the current IRS interpretation is that it effectively ignores the words "on behalf of a candidate", and appears instead to adopt the concept of "influencing the outcome of an election" found in the private foundation rules.[14] The USCC analysis concluded that the proper construction of the political campaign activity restriction is that charitable organizations are prohibited from taking part in a political campaign only when specifically representing, acting in the interest of, or for the benefit of, a candidate for public office. This construction would limit prohibited activity to actions taken specifically and unambiguously to benefit a candidate, such as explicit endorsements of or opposition to a candidate, or cash or in kind contributions to a candidate of PAC.

B. Legislative History. The political campaign activity restriction of section 501(c)(3) was added to the Code in 1954 as an amendment proposed by then Senator Lyndon B. Johnson during a Senate floor debate. At least one commentator, Bruce Hopkins, who testified before this Subcommittee on March 12th, has indicated that the 1954 amendment sought to curb the activities of private foundations like one in Texas that LBJ "believed had provided indirect financial support to a campaign opponent."[15] Another indicates that "LBJ was irritated at the H. L. Hunt Foundation's activity against him when he ran for the Senate in Texas...."[16] Research into the legislative history of the political campaign activity restriction, which was conducted at USCC's request at the LBJ Library in Austin, revealed that Senator Johnson may have been concerned with the activities of an organization known as the Committee for Constitutional Government on behalf of his opponent in the 1954 Democratic primary campaign, Dudley Dougherty.[17] Unfortunately, the paucity of legislative history surrounding the amendment renders it useless as an extrinsic aid in interpreting the scope of the statute.

13/ See Treas. Reg. §1.527-7(q); S. Rep. No. 93-1357, 1975-1 C.B. 517, 534.

14/ I.R.C. §4945(d)(2).

15/ B. Hopkins, The Law of Tax-Exempt Organizations 247 (4th ed. 1983). (emphasis added).

16/ Non-Profit Organization Tax Letter, Vol. XXII, No. 4, at 2 (March 23, 1984).

17/ See Exhibit #1 at 9.

C. IRS Voter Education Rulings. Much of the controversy surrounding the political campaign activity prohibition relates to voter education activities. IRS espouses the principle that such activities conducted in a nonpartisan manner do not constitute prohibited political campaign activity. Accordingly, IRS has approved unbiased candidate forums, debates and lectures sponsored by charitable organizations, in which the speakers explain their views to the public.[18] IRS has also approved the provision of free air time to all legally qualified candidates by charitable organizations operating broadcast stations, if FCC requirements are met.[19]

In 1978, however, IRS attempted to narrow severely the scope of permissible voter education activity. Objection was so strenuous that IRS revoked a revenue ruling it had issued only months earlier. The replacement ruling, Rev. Rul. 78-248, posed four hypothetical fact situations, two of which were viewed as violating the political campaign activity restriction.[20] Rev. Rul. 78-248 is set forth in its entirety on page 175 of an article written for the University of Virginia Journal of Law and Politics by the former USCC General Counsel and current USCC Associate General Counsel, which is attached as Exhibit #2. Each of the four situations involves some form of voter guide, i.e. incumbents' voting records or responses to candidate questionnaires, which was distributed widely to the electorate during a campaign.

Situation #4 is particularly troublesome. It identified two characteristics which, if combined, will render voter education activity prohibited political campaign activity. Specifically, if voter education material is widely distributed, but focuses only on a single issue or a narrow range of issues, IRS characterizes it as prohibited political campaign activity, even if no statements of support for or opposition to any candidate are made. In other words, partisan motivation is imputed to voter education materials unless they cover a wide variety of issues.

III. Infirmities in Current Political Campaign Activity Restriction

A more complete analysis of the constitutional infirmities of the political campaign activity restriction of section 501(c)(3) is contained in the University of Virginia article attached as Exhibit #2, which we recommend for the Subcommittee's consideration. However, we would like to summarize briefly two major arguments made therein, namely that the political campaign activity restriction as interpreted by IRS is unconstitutionally vague and overbroad, and infringes the Free Exercise rights of churches and other religious organizations.

---

[18] See Rev. Rul. 66-256, 1966-2 C.B. 210.

[19] See Rev. Rul. 74-574, 1974-2 C.B. 160.

[20] Rev. Rul. 78-248, 1978-1 C.B. 154.

A. *Vagueness and Overbreadth*. Generally, the vagueness doctrine requires that a statute give a person of ordinary intelligence fair notice that his contemplated conduct is forbidden by the statute,[21] and provide officials with sufficient guidelines in order to avoid arbitrary and discriminatory enforcement.[22] A statute is unconstitutionally overbroad if it "does not aim specifically at evils within the allowable area of [government] control, but...sweeps within its ambit other activities" that constitute the exercise of First Amendment rights.[23]

The vagueness and overbreadth doctrines raise distinct constitutional questions with regard to the political campaign activity restriction. The scope of impermissible "participation" or "intervention" in a political campaign is not readily apparent from the words of the statute. The lack of elucidating legislative history compounds the problem. In addition, the Regulations provide little guidance regarding what is covered by the restriction beyond the most obvious forms of activity, *e.g.*, explicit endorsements or statements of opposition to candidates. Finally, the voter education rulings fail to supply meaningful guidance to those who seek to adhere to them. Essential terms such as "bias", "implied approval or disapproval", and "wide variety of issues" remain undefined. Frequently, tax-exempt organizations can only guess when applying the Regulations and IRS rulings to their own situations.

Thus, the political campaign activity restriction suffers from vagueness and obvious lack of objective standards. In addition, because of its broad scope, it is vulnerable to an overbreadth challenge. As a result, the restriction substantially deters protected speech. However, courts are reluctant to invalidate a statute on constitutional grounds unless a narrow, saving, construction cannot reasonably be adopted. Such a limiting construction was applied by the Court in *Buckley v. Valeo*,[24] to salvage from unconstitutionality a disclosure provision of the Federal Election Campaign Act ("FECA") affecting persons making contributions or expenditures "for the purpose of...influencing" the nomination or election of candidates for federal office.[25] There the Court construed the provision as reaching "only funds used for communications that *expressly advocate* the election or defeat of a clearly identified candidate".[26] A similar interpretation is required to "save" the political campaign activity restrictions.

---

[21] *See United States v. Harriss*, 347 U.S. 612 (1954).

[22] *See Big Mama Rag, Inc. v. United States*, 631 F.2d 1030, 1035 (D.C. Cir. 1980).

[23] *Thornhill v. Alabama*, 310 U.S. 88, 97 (1940).

[24] 424 U.S. 1, 74-82 (1976).

[25] 2 U.S.C. §431(e)(1); §431(f)(1); §434(e).

B. Free Exercise Concerns. By requiring religious organizations to choose between the benefits of tax exemption and engaging in religiously motivated speech, section 501(c)(3) clearly burdens their Free Exercise rights, which include the right to preach, teach and proselytize.[27] Churches and other religious organizations rightly consider themselves obliged to speak out on the moral aspects of social, economic and political issues. The responsibility of the representatives of the Catholic Church to address the moral and religious dimensions of issues facing this society derives directly from Catholic theology and social doctrines. The Catholic Bishops have stated:

> [I]t is the Church's role as a community of faith to call attention to the moral and religious dimension of secular issues to keep alive the values of the Gospel as a norm for social and political life, and to point out the demands of the Christian faith for a just transformation of society.[28]

When this role coincides with the electoral process, which brings into clearer focus the conflicting opinions on many issues, every sermon on a controversial issue in which the candidates are on opposite sides, and every report in the religious press on the views of candidates running for office raises a potential question of the appropriate application of the political campaign activity restriction. The current broad IRS interpretation of the restriction has a substantial chilling effect on the role of churches and religious organizations in discussing not only particular candidates' views on issues of importance to members of the faith, but also in discussing the issues themselves.

This situation raises serious questions of infringement of Free Exercise rights. Such infringement may only be justified by a compelling state interest.[29] However, there is no legislative history to indicate precisely

---

26/ 424 U.S. at 77. (emphasis added).

27/ See McDaniel v. Paty, 435 U.S. 618, 626 (1978) (plurality).

28/ Political Responsibility: Choices for the 1980s, A Statement of the Administrative Board of the United States Catholic Conference 2 (Rev. ed. March 22, 1984). (Copy attached as Exhibit #3).

29/ The recent Supreme Court opinion in Hobbie v. Florida Unemployment Commission, ____ U.S. ____, 55 U.S.L.W. 4208 (Feb. 24, 1987) rejected the assertion based on Bowen v. Roy, 106 S.Ct. 2147 (1986) (Burger, C.J.) that a neutral restriction equally applicable to everyone can be justified on a lesser standard. The Court soundly reaffirmed the compelling state interest doctrine.

the "evil" the political campaign activity restriction was intended to remedy. One court has stated that both the political campaign activity and legislative restrictions "stem from Congressional policy that the United States Treasury should be neutral in political affairs and that substantial activities directed to attempts to influence legislation or affect a political campaign should not be subsidized."[30] The validity of this interest is suspect since the partisan political activities of other groups are, to one degree or another, subsidized by the public fisc. For example, PACs are exempt from income tax on funds received, segregated and used to influence the election of candidates for public office.[31] Tax-exempt labor unions, business leagues, social welfare organizations, and veterans' organizations may establish and solicit contributions to separate segregated funds that are operated and taxed as PACs.[32] Finally, contributions to veterans' organizations, upon which no political campaign restrictions are imposed, are deductible under section 170(c)(3).[33] The alleged "interest" seems far from compelling.

To justify a burden on Free Exercise rights, a compelling Government interest must be achieved by the least restrictive means.[34] Even assuming, arguendo, that the government has a compelling interest in not subsidizing a charitable organization's partisan politics, the extreme sanctions of loss of tax exemption and of deductibility of all contributions can hardly be regarded as the least restrictive means of accomplishing the government's purpose.

The recent Supreme Court decision in Federal Election Commission v. Massachusetts Citizens for Life, Inc.[35] illustrates the principles outlined above. In that case, the Court found that FECA restrictions on independent corporate spending were unconstitutional as applied to the publication and distribution of voter education material by a nonprofit ideological corporation, because they infringed protected speech without compelling justification. There, the voter education material was similar to that described in Situation #4 of Rev. Rul. 78-248 in that it covered only abortion-related issues and was widely distributed. Despite the clear legislative history of FECA regarding the intent of the provision at issue "to prohibit...use of union or corporate funds for active electioneering directed at the general public on behalf of a candidate in a Federal election,"[36] the Court concluded that the government's stated interests in the regulation of corporate political activity did not exist with respect to MCFL, and thus there was no justification for FECA's infringement on MCFL's First Amendment rights. In view of its virtually nonexistent legislative history and its substantial burden on Free Exercise rights, the political campaign activity restriction is unlikely to pass constitutional muster.

---

[30] Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849, 854 (10th Cir. 1972), cert. denied, 414 U.S. 864 (1973) (emphasis omitted).

[31] See I.R.C. §527.

[32] See I.R.C. §527(f)(3).

[33] I.R.C. §170(c)(3).

[34] Thomas v. Review Board, 450 U.S. 707, 718 (1981).

[35] 107 S.Ct. 616 (1986).

IV. Recommendations

A. Lobbying Restriction. Despite objections on constitutional grounds, USCC and the organizations covered in the USCC group exemption ruling have learned to live within the parameters of the "substantiality test". USCC is not eligible to make the lobbying expenditure election. Therefore, at this time, we make no recommendations for altering the current treatment of churches or church-related organizations under section 501(c)(3) or 501(h).

B. Political Campaign Activity Restriction. Because there exists no significant legislative history, and because the political campaign activity restriction burdens fundamental First Amendment rights, the restriction should be narrowly interpreted as applicable only to express advocacy of clearly identified candidates. Under such a construction, prohibited activity should be limited to explicit endorsements of or opposition to a political candidate, or other clear and unambiguous support (financial or otherwise) of a political candidate. Voter education materials should not constitute prohibited activity unless they contain explicit statements of support for or opposition to a candidate or other specific voting instruction. Such an approach would serve both the enforcement interests of IRS and the interests of charitable organizations seeking to operate within the limits of the law. With clear and objective standards in place, it would be easier for IRS to enforce the restriction against violators, and charitable organizations could enter the public policy debate without fear of losing their tax-exempt status.

Specifically, IRS should revoke the current voter education revenue rulings. If replacements are deemed necessary, rulings might be published that describe clear violations under a proper narrow construction, *e.g.*, explicit endorsement of or opposition to clearly identified candidates, or cash or in kind contributions to candidates or PACs. Finally, some time limit should be placed on what constitutes a "political campaign". Presidential candidacies that are commonly declared two years before the general election pose a virtually impossible burden on organizations to decide when and how to address the issues.

We thank you for your consideration of these remarks, and would be happy to assist the Subcommittee in its further deliberations.

---

[36] 117 Cong. Rec. H43379 (1971) (Comments of Rep. Hansen).

EXHIBIT #1

UNITED STATES CATHOLIC CONFERENCE
1312 MASSACHUSETTS AVENUE N.W., WASHINGTON, D.C. 20005 (202) 659-6690

Office of General Counsel

August 8, 1986

Robert I. Brauer
Assistant Commissioner for Employee
  Plans and Exempt Organizations
Internal Reveue Service
1111 Constitution Avenue
Washington, D. C. 20024

Dear Commissioner Brauer:

This letter addresses the issue whether the current IRS interpretation of the restriction on the poltical campaign activities of charitable organizations ("political activity restriction") under section 501(c)(3) of the Internal Revenue Code ("Code") accords with the language and intent of the statute. It is submitted as a result of our meeting last year which my assoicate, Deirdre Dessingue, and I had with you and several of your associates.

I. INTRODUCTION

The United States Catholic Conference ("USCC") is a nonprofit corporation whose membership is comprised of the active Catholic bishops of the United States. It is exempt from federal income tax under section 501(c)(3) of the Code. It also holds a group ruling, which is reaffirmed annually, establishing the federal tax exemption of thousands of Catholic organizations listed in the Official Catholic Directory. The most recent reaffirmation letter is dated June 30, 1986. USCC's interests in this issue are both institutional and representational.

First, in Abortion Rights Mobilization, Inc. v. Baker [1] the tax-exempt status of USCC and the National Catholic Conference of Catholic Bishops ("NCCB") has been challenged by third parties who allege that USCC and NCCB, as well as other Catholic entities, have engaged in partisan political activity relative to the legal status of abortion, which is deemed immoral by the Roman Catholic Church. IRS's alleged failure to curb such activities is claimed to be a violation of section 501(c)(3) of the Code and the Establishment Clause of the first amendment. In their complaint, plaintiffs demand that the district court compel IRS to revoke the tax-exempt status of USCC and NCCB, to assess and collect all taxes due on revocation, and to cause USCC to notify contributors that contributions are no longer deductible under section 170. Although no longer parties, USCC and NCCB face costly and burdensome discovery, deeply intrusive of the privacy of the Church.

---

[1] No. 80 Civ. 5590 (RLC) (filed S.D.N.Y. October 2, 1980).

Second, USCC represents the interests of thousands of Catholic institutions that claim exemption under section 501(c)(3) by virtue of the USCC group ruling. These organizations operate under the same restrictions as USCC with respect to their ability to speak out on critical moral issues. If the USCC group exemption ruling were revoked, these entities would be forced to seek separate exempt status, if a substitute group ruling holder could not be identified.

Churches and other religious organizations rightly consider it their obligation to speak out on the moral aspects of social, economic, and political issues.[2/] The responsibility of the representatives of the Catholic Church to address the moral and religious dimensions of issues facing this society derives directly from Catholic theology and social doctrines. The contributions of religious organizations to political discourse in this country are an essential aspect of free speech. When that contribution to debate coincides with the electoral process, every sermon on a controversial issue in which the candidates are on opposite sides, and every report in the religious press on the views of candidates running for office, raises a potential question of the appropriate application of the political activity restriction. Current IRS interpretation of that restriction strictly limits the role of churches and religious organizations in discussing not only particular candidates' views on issues of importance to members of the faith, but also in discussing the issues themselves. Indeed, the IRS' current broad interpretation presents serious questions of infringement on the "free exercise" and "free speech" rights of religious organizations.[3/]

On the practical side, third-party litigation presents an opportunity for those opposed to a religious organization on matters of paramount moral and social importance to use the federal courts to second guess IRS' enforcement of the tax

---

[2/] See generally, A. Reichley, Religion in American Public Life (Brookings Institution 1985).

[3/] See generally, Caron and Dessingue, IRC §501(c)(3): Practical and Constitutional Implications of "Political" Activity Restrictions, 2 Journal of Law & Politics 169 (1984).

laws.[4] This presents a substantial burden both for the religious organization and the government, a burden that is largely a result of the IRS' current expansive interpretation of the political activity restriction. In particular, the voter education revenue rulings, which extend the reach of the restriction far beyond the text or intent of the statute, provide a "blueprint" encouraging third-party allegations of IRS nonenforcement.

This letter analyzes the language and legislative history of the political activity restriction under section 501(c)(3) of the Code, and makes recommendations for an interpretation of that restriction more consistent with statutory language and constitutional principles.

II. STATUTORY LANGUAGE

Section 501(c)(3) of the Code grants federal income tax exemption to charitable, educational, religious, etc. organizations that do not ". . .participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office."[5] This language was added to the Code in 1954 as an amendment proposed by then Senator Lyndon B. Johnson during a Senate floor debate.[6]

The meaning of the political activity restriction must be sought in the first instance in the language of the statute itself. If that language is plain, there is no need for further inquiry.[7] "There is no safer nor better settled canon of interpretation than that when language is clear and unambiguous it must be held to mean what it plainly expresses."[8] Thus, the primary means of statutory interpretation is intrinsic construction - examination of the structure and language of the text itself.

---

[4] See, e.g., Keane v. Secretary of Treasury (filed W.D.N.Y. June 19, 1986), an action for declaratory and injunctive relief demanding that IRS declare the Fund for American Renaissance to be engaged in prohibited political activity.

[5] I.R.C. §501(c)(3).

[6] 100 Cong. Rec. S9604 (daily ed. July 2, 1954).

[7] 2A Sutherland Stat. Const., §46.01 at 73 (4th ed. 1972) [hereinafter "2A Sutherland"]; see Tennessee Valley Authority v. Hill, 437 U.S. 153, 184 n. 29 (1978).

[8] 2A Sutherland, §46.01 at 73, quoting Swarts v. Siegel, 117 F. 13 (1902).

Analysis of the structure and language of the political activity restriction yields the following results. The terms "participate" and "intervene", without more, might be susceptible of a breadth of meaning[9] which the balance of the political activity restriction will not permit. The political activity restriction applies only to participation or intervention conducted "on behalf of" a political candidate, meaning "in the interest of", "as the representative of", or "for the benefit of".[10] Thus, the phrase "on behalf of" limits materially the meaning of the political activity restriction. Charitable organizations are prohibited from taking part in, sharing in, or coming between to modify or hinder a political campaign only when specifically representing, acting in the interest of, or for the benefit of a candidate for public office. Current IRS interpretation, particularly as evidenced in the voter education revenue rulings,[11] effectively ignores the words "on behalf of a candidate," and adopts instead the concept of "influencing the outcome of an election" that appears in section 4945(d)(2) of the Code.[12] That provision penalizes private foundations for actions that may "influence the outcome" of an election, even if not undertaken on behalf of any candidate.

In analyzing the statutory text, it also becomes necessary to determine the reach of the prohibited "participation" or "intervention" in a campaign on behalf of a candidate. With the exception of the parenthetical phrase "including the publishing or distributing of statements," the statutory text does not enumerate specific prohibited activities. Use of the word "include" suggests that the restriction was intended to apply to means beyond the publishing or distributing of statements, but

---

9/ "Participate" is defined as "to take part in something (as an enterprise or activity) usually in common with others" and "to have a part or share in something." Webster's Third New International Dictionary 1646 (Unabridged 1976). "Intervene" means "to come in or between by way of hindrance or modification." Id. at 1183.

10/ Id. at 198.

11/ Rev. Rul. 78-248, 1978-1 C.B. 154; Rev. Rul. 80-282, 1980-2 C.B. 178.

12/ I.R.C.§4945(d)(2). See Note, Regulating the Political Activity of Foundations, 83 Harv. L. Rev. 1843, 1852-4 (1970).

how far beyond is not clear.[13]

Statutes impinging on fundamental freedoms are strictly (less inclusively) construed.[14] When the constitutionality of a statute is in question, and under one construction it can be upheld, while under another it cannot, courts will adopt the construction supporting constitutionality.[15] Accordingly, language in the Federal Elections Campaign Act ("FECA") regarding contributions or expenditures "for the purpose of... influencing the nomination or election of candidates for federal office" was construed narrowly by the Supreme Court "to reach only funds used for communications that expressly advocate the election or defeat of a clearly identified candidate. This reading is directed precisely to that spending that is unambiguously related to the campaign of a particular federal candidate."[16]

The extent to which the political activity restriction impinges on fundamental freedoms of speech and religion is discussed in some detail in our article published in the Journal of Law & Politics by the University of Virginia.[17] The arguments will not repeated herein, but a copy of the article is enclosed. Because of the constitutional implications of the political activity restriction, it is likely that courts would construe its reach very narrowly, as was done in Buckley v. Valeo.

III. EXTRINSIC AIDS

When reliance on the structure and language of the text is insufficient to establish the meaning of a statute, recourse may be had to extrinsic aids to construction, among them circumstances leading to a statute's enactment, events surrounding its enactment, developments pertinent to its subsequent operation[18], and interpretations of similar language in related statutes.

---

[13] 2A Sutherland, §47.23 at 194.

[14] 2A Sutherland, §58.04 at 715.

[15] 2A Sutherland, §57.24 at 698; see NLRB v. Catholic Bishop of Chicago, 440 U.S. 490, 500 (1979).

[16] Buckley v. Valeo, 424 U.S. 1, 80 (1976) (emphasis added).

[17] Caron and Dessingue, supra note 3.

[18] 2A Sutherland §48.01 at 277.

Pre-Enactment History

Information concerning the historical background of an enactment is relevant in determining how a statute should be construed and applied, particularly where the language of the statute is inadequate or unclear.[19] Among the sources of such background are court decisions, which may be consulted in the interpretation of statutes that restate decisional law, prior statutes on the same subject, and antecedent common law pertaining to the subject of the statute.[20]

Prior to 1934, the Internal Revenue Code contained no restrictions on lobbying or political activity, even though early Treasury Regulations contained a prohibition against partisan or controversial propaganda.[21] Slee v. Commissioner,[22] the leading pre-1934 case on the subject, involved the activities of the American Birth Control League in "agitating" for the repeal of laws preventing birth control. There the court concluded that gifts to the League were not deductible from federal income tax because the League's political activities precluded it from being classified as "exclusively" charitable, educational, or scientific. Judge Learned Hand stated, "[p]olitical agitation as such is outside the statute...controversies of that sort must be conducted without public subvention; the Treasury stands aside from them."[23]

In 1934, Congress enacted the current restriction on "substantial" lobbying activities by charitable organizations. An attempt to restrict substantial "participation in partisan polities" along with lobbying was unsuccessful.[24] It should be emphasized that had the 1934 limitation on political activity been enacted, it would only have imposed a "substantiality" standard for partisan political activity, as was the case for lobbying.

---

[19] 2A Sutherland, §48.03 at 290-1.

[20] 2A Sutherland, §50.01 at 421.

[21] Treas. Reg. 45, art. 517 (1919), T.D. 2831, 21 Treas. Decs. Int. Rev. 285 (1920). See also, Price v. Commissioner of Internal Revenue, 12 B.T.A. 1186 (1928), in which deduction was disallowed for contribution to an organization that engaged in "advocacy of or opposition to candidates". Note, Religion and Political Campaigns: A Proposal to Revise Section 501(c)(3) of the Internal Revenue Code, 49 Fordham L. Rev. 536, 545 (1981); Church Lobbying: The Legitimacy of the Controls, 16 Hous. L. Rev. 480, 489 (1979).

[22] 42 F. 2d 184 (2d Cir. 1930).

[23] Slee, supra note 22, at 185.

Commentators do not agree on what the 1934 lobbying restriction was intended to accomplish, particularly whether it was intended to codify the Slee decision or existing administrative policy.[25] One comentator notes that the drafters of the 1934 restriction did not seek to prohibit all lobbying, but rather, to prevent charities from engaging in lobbying for "ulterior motives".[26] However, the drafters experienced difficulties crafting language to reflect this limited concern.[27]

Early American common law of charity did not require absention from political activity as a prerequisite to charitability. This view developed generally only after tax benefits were granted to charitable organizations.[28] The touchstone of charitability is a benefit to the community.[29] In the American view, the charitable character of a trust is not defeated merely because the accomplishment of its charitable purpose may involve pursuit of a change in existing law.[30] A trust to promote the success of a particular political party is not considered charitable, on the theory that "there is no interest in the community" in underwriting a political party.[31] However, the charitability of a trust to promote a particular cause is not defeated by the fact a political party advocates that cause.[32] This distinction is particularly important in the interpretation of the political activity restriction. American common law of charity would seem to support a prohibition of clearly partisan political activity, *e.g.*, endorsements of particular candidates or contributions to PACS or political parties, but not a more expansive issue-oriented interpretation of the political activity restriction. An exempt organization's activities with respect to a particular issue, *e.g.*, abortion, do not become less charitable because a party or candidate happens to espouse similar views on the subject.

---

[24] See S. Rep. No. 558, 73rd Cong., 2d Sess. 26 (1934).

[25] E. Clark, The Limitation on Political Activities: A Discordant Note in the Law of Charities, 46 Va. L. Rev. 439, 446-49 (1960); Church Lobbying, supra note 21 at 489. Part of the interpretational difficulty may stem from an issue of semantics. The Slee case utilizes the terms "political agitation" and "political activity" to characterize the League's attempts to repeal anti-birth control legislation. Under current section 501(c)(3) interpretation and usage, these activities would be categorized as "lobbying", rather than "political activity".

[26] Church Lobbying, supra note 21 at 488. Senator Reed stated, "there is no reason in the world why a contribution made to the National Economy League should be deductible as if it were a charitable contribution if it is a selfish one made to advance the personal interests of the giver of the money. That is what the committee were [sic] trying to reach...." 78 Cong. Rec. 5861 (1934) (Remarks of Senator Reed).

[27] Senator Reed stated, "[w]e found great difficulty in phrasing the amendment. I do not reproach the draftsmen. I think we give them an impossible task; but this amendment goes much further than the committee intended to go." Id.

The historical background to the enactment of a statute also can serve as a useful extrinsic aid to interpretation by providing important information concerning the mischief the statute was intended to correct. Such pre-enactment history becomes particularly significant with respect to the political activity restriction, whose enactment history is devoid of explicit information regarding the precise mischief sought to be remedied.

---

[28] *See* E. Wachtel, *David Meets Goliath in the Legislative Arena*, 9 San Diego L. Rev. 944, 947-8 (1972); J. Clear, *Political Speech of Charitable Organizations under the Internal Revenue Code*," 41 U. Chic. L. Rev. 352, 367 (1974).

[29] Restatement (Second) of Trusts §374 (1959).

[30] *Id.* §374 comment j; 4 Scott, Law of Trusts, §374.4 (3d ed. 1967); Note, *Charitable Trusts for Political Purposes*, 37 Va. L. Rev. 988, 989-993 (1951).

[31] Restatement, *supra* note 29, §374 comment k; *see also* Scott, *supra* note 29, §374.6.

[32] *Id.*; *see also*, Note, *supra* note 30 at 993-996. An early opinion recognized the charitabilty of a trust supporting a political party if its goal was to support a particular cause by this means. Buell v. Gardner, 83 Misc. 513, 519-20, 144 N.Y. Supp. 945 (Sup. Ct. 1914).

At least one commentator has indicated that the 1954 amendment sought to curb the activities of private foundations like one in Texas that LBJ "believed had provided indirect financial support to a campaign opponent."[33] Another indicates that "LBJ was irritated at the H.L. Hunt Foundation's activity against him when he ran for the Senate in Texas...."[34]

LBJ's opponent in the Democratic primary in the summer of 1954 was Dudley Dougherty, a rich Catholic rancher from near Beeville, Texas. The political activity amendment was offered on July 2, 1954, during the middle of the primary campaign. Research conducted at our request at the LBJ Library in Austin uncovered a June 15, 1954 memorandum ("Exhibit A") from Gerald W. Siegel, which responded to LBJ's question "...whether any Texas election laws may have been violated by the action of the Committee for Constitutional Government...by printing a box on its brochure urging people to write to Dougherty and let him know their views on his platform." Siegel advised LBJ that the officers of the Committee for Constitutional Government had indeed violated the Texas Election Code, finding that "...in distributing this material in Texas it has clearly engaged in an indirect, if not direct, effort to influence a senatorial election by aiding the candidacy of Dougherty and attempting to defeat your candidacy." Siegel also noted the limitations of the federal tax-exemption statute, which at that time restricted only the lobbying activities of charitable organizations. Dated less than three weeks prior to the introduction of the floor amendment, this memorandum bears directly on LBJ's interest in the political activity restriction.

Our subsequent efforts to gather information concerning the Siegel memorandum were generally unsuccessful. Attached as "Exhibit B" is correspondence between USCC representatives and George Reedy, then LBJ's chief aide, and Gerald Siegel, then Counsel to the Senate Democratic Policy Committee. Mr. Reedy's response is self-explanatory. Mr. Siegel responded by phone, indicating that due to the passage of time, he was unable to recall any particulars.

Additional correspondence reveals that LBJ may have induced Rep. John W. McCormack to write, on June 18, 1954, to then Commissioner of Internal Revenue, T. Coleman Andrews, concerning the exempt status of the above-cited Committee for Constitutional

---

[33] B. Hopkins, The Law of Tax-Exempt Organizations 247 (4th ed. 1983).

[34] Non-Profit Organization Tax Letter, Vol. XXII, No. 4, at 2 (March 23, 1984).

Government, Inc., and the Constitution and Free Enterprise Foundation, Inc. Rep. McCormack's reply to LBJ, enclosing the response from Commissioner Andrews, was received on July 2, 1954, the very day the political activity restriction amendment was introduced on the Senate floor. This correspondence is attached as "Exhibit C".

Enactment History

Enactment history focuses on circumstances and events at the time a bill is enacted. This category of legislative history is not very useful unless it is clear and authoritative. "Where legislative history is ambiguous, a court must look to intrinsic aids."[35] Because the political activity restriction was added in floor debate, there is virtually no enactment history to indicate precisely the "evil" it was intended to remedy, or to otherwise assist in the interpretative task. In introducing the amendment, LBJ stated "...[t]his amendment seeks to extend the provisions of section 501 of the House bill, denying tax-exempt status to not only those people who influence legislation but also to those who intervene in any political campaign on behalf of any candidate for any public office."[36] Mere extension of the treatment accorded exempt organizations engaged in lobbying, however, would result in a "substantiality" test for political activity, rather than a prohibition,[37] which is the same treatment that would have been accorded partisan political activity under the rejected 1934 amendment.

Post-Enactment History

Circumstances developing after enactment of a statute may be significant in determining the meaning conveyed by the statute. Generally, the weight given contemporaneous and post-enactment interpretation of a statute depends on whether: (1) the interpretation originated from a reliable source; (2) the interpretation was made at or near the time of the enactment; and (3) the interpretation continued for a long period of time and received wide acceptance and following.[38]

---

[35] 2A Sutherland, §48.01 at 278.

[36] 100 Cong. Rec., supra note 6.

[37] See GCM 39441 (September 27, 1985) wherein IRS admits a de minimus exception to the political activity restriction.

Post-enactment construction includes "judgments and responses of administrative authorities, enforcement officials, and others closely involved in the ongoing operation of a statute."[39] While not conclusive of meaning, administrative construction involving agency expertise has been given great weight in determining a statute's operation. As one court has stated, "[w]e are without authority to overturn an administrative interpretation of an act or regulations adopted thereunder unless it can be said that the construction of the act is 'plainly erroneous or inconsistent with the regulation'.... Even though our views with regard to interpretation differ from those of the administrative agency we would not be authorized to substitute our views if it could be said that the administrative interpretation was a reasonable one."[40]

On the other hand, courts do not defer to administrative interpretation in regard to questions which do not lie within an administrative agency's special expertise.[41] In addition, other circumstances indicating that an administrative interpretation was arrived at without adequate consideration may reduce the weight given it by a reviewing court.[42] Finally, an administrative interpretation may not be used to achieve a result beyond the terms of the statute properly construed.[43]

IRS' post-enactment interpretations of the political activity restriction (the voter education rulings) would likely be given little weight by the courts. First, IRS revenue rulings are not authoritative, but rather merely interpretations of the Code and regulations applied to a set of facts, intended to guide

---

[38] 2A Sutherland, §49.04 at 358.

[39] 2A Sutherland, §49.01 at 348.

[40] 2A Sutherland, §49.04 at 357, _quoting_ Jno. McCall Coal Co. v. United States, 374 F.2d 689, 691-2 (4th Cir. 1967).

[41] _Id._ at 358.

[42] 2A Sutherland §49.05 at 363.

[43] _Id._ at 364.

IRS employees and taxpayers.[44] Even IRS cautions against reliance upon them in other cases unless the facts and circumstances are essentially the same.[45] Second, the voter education rulings were not issued at or near the time of the restriction's enactment, but rather some 24 and 26 years later. Thus, they do not represent longstanding interpretations. In 1978, IRS issued its initial voter education ruling,[46] which was hastily withdrawn in the face of strong opposition; Rev. Rul. 78-248 was the hurriedly-developed replacement. Third, it is abundantly clear that the voter education rulings have not received wide acceptance or following, but rather have given rise to protest and misunderstanding from the time of their issuance. Finally, IRS' preeminence lies in the field of taxation, not political campaign activity or the construction of statutory provisions of the kind involved here. Accordingly, courts would owe no deference to IRS interpretations of what does or does not constitute intervention in a political campaign.

Related Statutes

Other statutes dealing with the same subject as the statute being construed may constitute an extrinsic aid to construction.[47] The Federal Elections Campaign Act ("FECA") [48] regulates all Presidential, as well as other federal elections, by restricting contributions and expenditures in connection with such elections and imposing various disclosure requirements. Tax-exempt corporations, including religious corporations, are subject to FECA's provisions.[49] Thus, it is appropriate to consider the interpretation of various FECA provisions in the construction of the political activity restriction. Indeed, FECA provides that the FEC and IRS shall consult to promulgate rules, regulations, and forms which are mutually consistent.[50]

---

[44] Rev. Proc. 78-24, 1978-2 C.B. 503, S3.01. See Biddle v. Commissioner, 302 U.S. 573, 582 (1938); Helvering v. New York Trust Co., 292 U.S. 455, 468 (1934).

[45] Rev. Proc. 78-24 at S7.01(5).

[46] Rev. Rul. 78-160, 1978-1 C.B. 153.

[47] 2A Sutherland, S51.01 at 449.

[48] 2 U.S.C.A. S431 *et seq*.

[49] During Senate debates on 1947 amendments to the Corrupt Practices Act, Senator Taft confirmed that the prohibitions against corporate contributions in connection with elections would apply to a corporation established for religious purposes. See 93 Cong. Rec. 6440 (1947).

Important provisions of FECA were reviewed by the Supreme Court in the Buckley case,[51] in which the Court generally upheld the constitutionality of FECA's limitations on contributions to candidates and struck down as unconstitutional limitations on independent expenditures, i.e. those not coordinated with a candidate or his authorized political committee.[52] The Court held that speech not by a candidate or political committee could be regulated only to the extent that the communications "expressly advocate the election or defeat of a clearly identified candidate."[53] The Court indicated that "explicit words of advocacy of election or defeat of a candidate inlcude 'vote for', 'elect', 'support', 'Smith for Congress', 'defeat', 'reject', etc."[54] FECA was subsequently amended to conform to the Buckley requirement of express advocacy.[55]

In FEC v. Central Long Island Tax Reform Immediately Committee,[56] the court considered the application of FECA to the following set of facts. A national membership corporation disseminated to its local committees a quarterly bulletin that included: (1) positions with respect to certain economic and tax issues; (2) the voting records of all members of Congress on specific legislation concerning these issues, along with a characterization of votes as "For Lower Taxes and Less Government" or "For Higher Taxes and More Government;" and (3) a commentary reflecting the organization's views on the merits of the bills identified.[57] The bulletin requested local committees to use photos of congressmen to permit voters to connect them with their voting records. One local committee distributed a bulletin which reported the voting record of a local congressman, charted and characterized 24 of his votes, and made the organization's position clear through slogans and commentary.[58] The court concluded that distribution of this publication did not constitute express advocacy of the election or defeat of a candidate. In reaching its conclusion, the court emphasized that the publication contained nothing approaching an unambiguous statement in favor of or against the election of the congressman, made no reference to the congressman's party, whether he was running for re-election, or to the existence of an election or the act of voting in an election.[59] However, distribution of this publication would likely be interpreted by IRS as a violation of the political campaign activity restriction under the voter education rulings.

---

[50] 2 U.S.C.A. §438(f).

[51] Supra note 16.

[52] See FEC v. Nat'l Conserv. Pol. Action, 105 S. Ct. 1459, 1466 (1985).

[53] Supra note 16 at 80. FECA defines a clearly identified candidate as one whose name, photo, or likeness appears or whose identity is apparent by unambiguous reference. 2 U.S.C.A. §431(18).

[54] Id. at 44, n. 52.

[55] See 2 U.S.C.A. §§ 434(e), and 441(d) as amended by Pub. L. 94-283, Title I, 90 Stat. 481.

[56] 616 F.2d 45 (2d Cir. 1980).

FECA prohibits corporate contributions or expenditures "in connection" with certain federal elections.[60] In this context, the term "contribution or expenditure" is defined to include "any direct or indirect payment, distribution, loan, advance, deposit or gift of money, or any services, or anything of value...to any candidate, campaign committee, or political party or organization, in connection with any election...."[61] Corporations may, however, use their treasury funds to operate voluntary separate segregated funds for political purposes.[62]

Federal Election Commission v. Massachusetts Citizens for Life, Inc. ("MCFL") recently applied the above corporate expenditure prohibition to the distribution of a "Special Election Edition" publication by MCFL, a nonprofit, nonmembership corporation.[63] The publication contained the voting records on abortion-related issues of many candidates for federal and state offices, exhorted readers to "vote pro-life", identified by name each candidate who supported and opposed what MCFL considered the pro-life position, and included photographs only of those candidates considered "pro-life". The court held that the Special Election Edition violated the FECA corporate expenditure prohibition, and that it did not qualify under the FECA exemption for newspapers, magazines or periodical publications.[64] The court further held, however, that application of the corporate expenditure prohibition to indirect, uncoordinated (with any candidate or political committee) expenditures by MCFL, a non-profit ideological corporation expressing its views of political candidates, violated MCFL's first amendment rights.

---

[57] Id. at 49.

[58] Id. at 49-51.

[59] Id. at 53.

[60] 2 U.S.C.A. §441b(a).

[61] 2 U.S.C.A. §441b(b)(2).

[62] 2 U.S.C.A. §441(b)(2)(C).

The application of corporate expenditure prohibition was found to be unconstitutional in MCFL despite the availability of an "alternative voice", i.e. the separate segregated fund. This holding belies the validity of the argument, based on Regan v. Taxation with Representation,[65] that a group's expenditures are not considered to be restricted if they can be financed through contributions to a separate affiliated corporation. It should be emphasized also that the court in MCFL stated that the phrase "Vote Pro-Life" did not constitute express advocacy within the meaning of Buckley, because it did not advocate the election or particular candidates for particular offices but rather urged support of a general position on a controversial issue.[66] The court thus recognized the material distinction between issue-oriented political activity and candidate-oriented political activity.

FECA serves several identified government interests: i) protection of the integrity of the electoral process from undue influence that could be exerted by accumulations of money by corporations; 2) protection of individuals whose money makes up a corporate treasury from use of their funds to support political candidates to whom they may be opposed;[67] and 3) ensuring that the electorate is fully informed about the sources of campaign financing.[68] No such governmental interests have been identified with respect to the political activity restriction. The legislative history of FECA is clear regarding the provision's intent among other things "to prohibit. . . .use of union or corporate funds for active electioneering directed at the general public on behalf of a candidate in a Federal election,"[69] whereas the legislative history of the political activity restriction is virtually nonexistent. Despite clear legislative history regarding the purpose and intent of FECA to serve important government interests, the Supreme Court narrowly construed certain FECA provisions that unduly burdened constitutionally protected rights to speak out during an election.[70] Consistency with constitutional principles requires an equally limited interpretation of the political activity restriction of section 501(c)(3).

---

[63] 769 F.2d 13 (1st Cir. 1985), jurisdiction noted, No. 85-701, 106 S. Ct 783 (January 13, 1986).

[64] 2 U.S.C.A. §431(9)(B)(i).

[65] 103 S. Ct. 1997 (1983). The operation of section 501(c)(4) "alter egos" to "save" the political activity restriction from unconstitutionality is questionable. The regulations prohibit indirect as well as direct political activity. Direction of a section 501(c)(4) "mouthpiece" to endorse candidates could be interpreted as violation of the prohibition against indirect political activity. See Caron and Dessingue, supra note 3 at 189-193.

[66] Supra note 63 at 20.

In this context, Supreme Court has noted that:[71]

> "Public discussion of public issues which are also campaign issues readily and often unavoidably draws in candidates and their positions, their voting records and other official conduct. Discussions of those issues, and as well more positive efforts to influence public opinion on them, tend naturally and inexorably to exert some influence on voting at elections."

In recognition of these facts, FECA has been interpreted as not reaching all partisan discussion.[72] Interpretation of the political activity restriction must be similarly limited.

---

[67] FEC v. National Right to Work Committee, 459 U.S. 197 (1982).

[68] *Supra* note 16 at 81.

[69] 117 Cong. Rec. H43379 (1971) (Comments of Rep. Hansen).

[70] *See* *Central Long Island Tax Reform*, *supra* note 58 at 53.

[71] *Supra* note 16 at 42, n. 50.

[72] *Id.* at 80.

IV. SUMMARY AND RECOMMENDATIONS

The text of the political activity restriction leads to the conclusion that charitable organizations are prohibited from taking part in a political campaign, when representing or acting in the interest be of a candidate for public office. This includes, but is not limited to, the publishing or distributing of statements. Because there exists no significant legislative history, and because the political activity restriction burdens fundamental first amendment rights (freedoms of speech and religion), the restriction must be narrowly interpreted as applicable only to express advocacy of clearly identified candidates, as the Supreme Court has interpreted FECA. Under a limited construction, prohibited political activity would include endorsements of a particular candidate or other clear and unambiguous support of a political candidate. Voter education materials, absent express endorsements, would not constitute political activity under a proper interpretation of the statute.

On the basis of the above analysis, and in view of the political activity restriction's adverse impact on the fundamental rights of charitable organizations, USCC respectfully suggests the following:

1) The current voter education revenue rulings should be revoked. _If_ replacements are deemed necessary, rulings might be published that describe clear violations under a proper narrow construction of the political activity restriction, _e.g._, _explicit_ endorsement of or opposition to clearly identified candidates, or cash or in kind contributions to candidates or PACs. Activities that do not constitute violations of the political activity restriction could also be identified. Among these would be communications that are issue-oriented, _e.g._, general statements such as "vote pro-life"; any voter education material that does not contain an express endorsement or other _specific_ voting instruction.

2) IRS should clarify the overlap between FECA (as interpreted by the courts) and the political activity restriction, and publish rulings accordingly.

3) IRS should identify clearly what constitutes a "political campaign."

We would be happy to participate in any process you might wish to organize to consider implementation of these recommendations.

Sincerly,

Wilfred R. Caron
General Counsel

June 15, 1954

File

GENER

Dougherty

MEMORANDUM

TO: Senator Johnson

FROM: Gerald W. Siegel GWS

SUBJECT: Possible violations of the Texas election laws by the Committee for Constitutional Government.

You have asked my opinion as to whether any Texas election laws may have been violated by the action of the Committee for Constitutional Government in circulating in Texas the Ballinger article on Dudley Dougherty and by printing a box on its brochure urging people to write to Dougherty and let him know their views on his platform.

This is a close question and without thorough examination of the precedents it is difficult to be sure how the statutory provisions will be interpreted to apply to such activity. It is my judgment, however, that the officers of the Committee for Constitutional Government have violated section 243(e) of the Texas Election Code.

The pertinent portions of 243(e) are: "If any officer, agent, or employee of any bona fide association, incorporated, or unincorporated, organized for or actively engaged for one (1) year prior to such contribution in purely religious, charitable or eleemosynary activities, or local, district, or state-wide commercial or industrial clubs, or associations, or other civic enterprises or organizations not in any manner, nor to any extent, directly or indirectly, engaged in furthering the cause of any political party, or aiding in the election or defeat of any candidate for office, or defraying or aiding in defraying the expenses of any political campaign, or political headquarters, or aiding or assisting the success or defeat of any question to be voted upon by the qualified voters of this State or any subdivision thereof, shall use or permit the use of any stock, money, assets, or other property contributed to such organizations by any corporations, to further the cause of any political party, or to aid in the election or defeat of any candidate for office . . . such officer, agent, or employee, shall be fined not less than One Hundred Dollars ($100) nor more than Five Thousand Dollars ($5,000) or, be imprisoned in the penitentiary not less than one (1) nor more than five (5) years, or be both so fined and imprisoned."

The Committee for Constitutional Government has openly solicited corporate contributions to its organization for its so-called educational purposes. It has been in existence for more than one year. As a federally qualified tax-exempt organization under Section 101(6) of the Internal Revenue Code, in distributing this material in Texas it has clearly engaged in an indirect, if not direct, effort to influence a senatorial election by aiding the candidacy of Dougherty and attempting to defeat your candidacy.

Section 101(6) of the Internal Revenue Code permits tax exempt organizations to engage in some efforts to influence legislation, so long as no substantial part of their activities are devoted to this function. The Committee has presumably not engaged, nor could it claim to have done so, in "furthering the cause of any political party," "aiding in the election or defeat of any candidate," or "defraying the expenses of any political campaign." It might, however, very properly contend that it has attempted to influence the "success or defeat of questions to be voted upon by the qualified voters of Texas, which presumably it can do under the federal tax laws without losing its exempt status. Under section 243(e) this might exclude it as one of the associations covered by that prohibition. It is in this area that the greatest doubt arises as to whether the Committee and its officers have in fact, violated Texas law.

In my judgment, section 243(e) is designed to prevent corporate contributions to political campaigns by indirect means through contributions to non-political organizations. If this is true, then notwithstanding its federally legal activities to influence legislation, the Committee for Constitutional Government should be regarded as in violation of section 243(e) by having provided an indirect means for corporations to contribute to the political candidacy of Dougherty.

The enforcement of criminal statutes is generally extremely technical and restricted. My opinion that a violation of this election code has occurred is not based upon a strong and clear conviction of such fact and certainly it does not represent a judgment that a conviction in the Courts could readily be obtained.

George E. Reedy
Nieman Professor of Journalism

MU Marquette University

Milwaukee, WI 53233
414-224-7132

October 11,1985

Dear Ms. Dessingue:

Unfortunately, I cannot be very helpful in responding to your query,other than clearing up the identity of Gerald W. Siegel. He was the General Counsel for the Senate Democratic Policy Committee amd later became Counsel for the Washington Post. When I last saw him--about two years ago--he had retired but still lived in Washington.

I have no recollection of the legislation itself which means that it was not a very important item in Johnson's mind. I would suspect that it had something to do with the Dudley Dougherty campaign as Dudley was backed only by the extreme--the really extreme--right wing. At no time did he pose any serious threat to the LBJ reelection campaign and my advice had been to ignore him completely other than keeping a watchful eye open. My advice turned out to be correct.

Lyndon B. Johnson was very thin skinned,however, and it is entirely possible that he was irritated by the activities of Dougherty's followers--especially H. L. Hunt. The language used by the conservatives during the campaign was vicious--which in my judgment made it an asset for LBJ. He obviously wanted to lash back in some fashion as I had to restrain him (by persuasion,of course) from making statements on more than one occasion.

Mr. Siegel may have some more information and I suggest you contact him. I am confident that Johnson would never have sought restrictions on religious organisations but that is only an opinion and I have no evidence.

Sincerely
George E. Reedy

Deirdre A. Dessingue
Associate General Counsel
United States Catholic Conference
1312 Massachusetts Avenue,N.W.
Washington,D.C. 20005

UNITED STATES CATHOLIC CONFERENCE
1312 MASSACHUSETTS AVENUE N.W., WASHINGTON, D.C. 20005 (202) 659-6690

Office of General Counsel

October 9, 1985

Professor George Reedy
Lucius W. Nieman Professor
of Journalism
Marquette University
1131 W. Wisconsin
Milwaukee, WI 53233

Dear Professor Reedy:

The USCC General Counsel and I earlier this year co-authored the enclosed article on the political activity restriction of section 501(c)(3) of the Internal Revenue Code, the effect of which is to deny tax-exemption to an organization that participates in a political campaign on behalf of a political candidate. To refresh your memory, that restriction was added to the Code in 1954 as a floor amendment proposed by then Senator Lyndon B. Johnson. As a result, there is no legislative history to indicate precisely why the amendment was offered. The history of the political activity restriction is of great interest to USCC, since USCC faces possible loss of its tax-exempt status for alleged violations of the restriction, as a result of third-party litigation.*/

One commentator has indicated that the political activity restriction sought to curb the activities of private foundations like one in Texas that LBJ believed had provided indirect financial support to a campaign opponent. Another commentator points the finger at the H.L. Hunt Foundation. Research conducted at the LBJ Library in Austin suggests that LBJ may have been concerned about certain activities of the Committee for Constitutional Government during the 1954 primary campaign against Dudley Dougherty. I've enclosed a copy of a memorandum relating to this subject. Certain facts continue to elude me, however, including the identity of Gerald W. Siegel and the import of the reference to the "Ballinger article" that is referred to in the memo.

I am writing in the hope that, because of your close relationship with LBJ, you might be able to shed some light on these matters and provide information concerning events leading up to the introduction of the 1954 amendment.

Thank you for your cooperation. Any information you might be able to provide will be gratefully received.

Sincerely,

Deirdre Dessingue
Deirdre A. Dessingue
Associate General Counsel

DAD/emm

Enclosures (2)

---

*/ The case is entitled Abortion Rights Mobilization v. Baker, and is discussed at page 180 of the article.

UNITED STATES CATHOLIC CONFERENCE
1312 MASSACHUSETTS AVENUE N.W., WASHINGTON, D.C. 20005 (202) 659-6690

Office of General Counsel

November 7, 1985

Gerald W. Siegel
4921 30th Place N.W.
Washington, D.C.

Dear Mr. Siegel:

The USCC General Counsel and I earlier this year co-authored the enclosed article on the political activity restriction of section 501(c)(3) of the Internal Revenue Code, the effect of which is to deny tax-exemption to an organization that participates in a political campaign on behalf of a political candidate. To refresh your memory, that restriction was added to the Code in 1954 as a floor amendment proposed by then Senator Lyndon B. Johnson. As a result, there is no legislative history to indicate precisely why the amendment was offered. The history of the political activity restriction is of great interest to USCC, since USCC faces possible loss of its tax-exempt status for alleged violations of the restriction, as a result of third-party litigation.*/

One commentator has indicated that the political activity restriction sought to curb the activities of private foundations like one in Texas that LBJ believed had provided indirect financial support to a campaign opponent. Another commentator points the finger at the H.L. Hunt Foundation. Our research at the LBJ Library in Austin suggests that LBJ may have been concerned about certain activities of the Committee for Constitutional Government during the 1954 primary campaign against Dudley Dougherty. I've enclosed a copy of a memorandum that you wrote in 1954 on this subject.

I am writing at the suggestion of George Reedy in the hope that you might be able to shed some light on these matters and provide information concerning events leading up to the introduction of the 1954 amendment.

Sincerely,

Deirdre Dessingue

Deirdre A. Dessingue
Associate General Counsel

Enclosures (2)

---

*/ The case is entitled Abortion Rights Mobilization v. Baker, and is discussed at page 180 of the article.

The Commissioner of Internal Revenue

Congressman:

We started on this while back.

28 June 54

LYNDON [illegible]

JOHN W. McCORMACK
12TH DIST., MASSACHUSETTS

EUGENE T. KINNALY
EXECUTIVE SECRETARY

BOSTON OFFICE
JAMES V. HARTREY
SECRETARY

Congress of the United States
House of Representatives
Office of the Democratic Whip
Washington, D. C.

July 1, 1954

Honorable Lyndon B. Johnson
Senate Office Building
Washington, D. C.

Dear Lyndon:

I know you will read the within that I have received from Commissioner Andrews with interest.

With kind regards, I am

Sincerely yours,

John

U. S. TREASURY DEPARTMENT
OFFICE OF COMMISSIONER OF INTERNAL REVENUE
WASHINGTON 25

June 28, 1954

Dear Mr. McCormack:

This is in response to your letter of June 18, 1954, concerning the exempt status of the Committee for Constitutional Government, Inc., and the Constitution and Free Enterprise Foundation, Inc.

The documents to which you refer, copies of which you attached to your letter of the 18th, are no less amusing and shocking to me than they are to you, and I can tell you that we are taking appropriate steps to see just what is the effect of the activities of these organizations under the internal revenue laws and what, if anything, can be done about their present status in relation to exemption privileges.

Respectfully,

T Coleman Andrews

T. Coleman Andrews
Commissioner

Honorable John W. McCormack
House of Representatives
Washington 25, D. C.

LYNDO